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FIRST SESSION

THURSDAY, MAY 19, 10:00 A. M.
The Ohio Union—West Ballroom

Presiding:

FRANK L. ARNOLD, *Vice President, The American Institute of Certified Public Accounants; Partner, Arnold, Hawk & Cuthbertson, Dayton, Ohio*

Paper: "Accounting Research for Better Financial Reporting"
CARMAN G. BLOUGH, *Research Director, American Institute of Certified Public Accountants, New York, New York*

Paper: "Changes in Auditing Procedures in an Expanding Economy"
JOHN PEOPLES, *Partner, Peat, Marwick, Mitchell & Company, New York, New York*

Paper: "Accountant's Responsibility for Disclosure of Irregularities"
RALPH JOHNS, *Partner, Haskins & Sells, Chicago, Illinois (Not Recorded)*

FIRST SESSION

PROFESSOR PAUL E. FERTIG: It is my purpose this morning only to bid you a cordial welcome to this first session of the twenty-second annual Institute on Accounting at The Ohio State University.

Your Chairman for this morning's session is Frank Arnold of Arnold, Hawk and Cuthbertson in Dayton. Frank is a Past President of the Ohio Society of CPAs, has been a member of Council, and serving on a great many AICPA committees for a number of years. He is Vice President of the American Institute of Certified Public Accountants. Mr. Arnold.

CHAIRMAN FRANK L. ARNOLD: Ladies and gentlemen: Again it is my pleasure and privilege to open another great Ohio State University Institute on Accounting. From the outline of the program, this twenty-second annual Institute of Accounting appears again to be one of the superior functions for the dissemination of accounting thinking to students of accounting as well as practicing accountants. As we all know, who have been in the accounting profession for some years, we must always remain a student of accounting, using every opportunity that presents itself to broaden our accounting knowledge.

It was six years ago when I opened this Accounting Institute, then as President of the Ohio Society of Certified Public Accountants. Today I am performing this service as Vice President of the American Institute of Certified Public Accountants. It is therefore with extreme pleasure to me personally that I have this opportunity to open this twenty-second annual Institute.

Our first speaker this morning is known to many of us as one of the leaders in the accounting profession. Ten years ago I had the opportunity of introducing him as a speaker to the Ohio Society convention in Cleveland. He made an outstanding talk to us there and on the occasions when I have heard him, he seems to improve. In my opinion, he, like the fine whiskey that comes from our neighboring state to the south, improves with age.

Mr. Blough was born in Johnstown, Pennsylvania. He is a graduate of Manchester College, A.B. and L.L.D.; University of Wisconsin, M.A. He has done additional graduate work at Columbia, Chicago and Harvard universities.

He holds C.P.A. certificates from nine states including Wisconsin. He has been a teacher of accounting and corporation finance; professor of accounting and head of the accounting department of the University of North Dakota; head of the social science department of Armour Institute of Technology; served as associate guest professor and adjunct professor of Columbia University.

His services during World War II were as Chief of the Contract Review Branch and Director of the Procurement Policy Division of the War Production Board, and as that Board's representative on the Price Adjustment Boards of the War, Navy, and Treasury Departments, Maritime Commission, Reconstruction Finance Corporation, and War Shipping Administration. He was a member of the U. S. War Contracts Price Adjustments Board, and consultant on Renegotiation and Termination of the War Production Board.

He also served with the Securities and Exchange Commission as Assistant Director of the Registration Division, following this service as S.E.C.'s first Chief Accountant. For four years our speaker was manager and partner of the accounting firm of Arthur Andersen and Company in Chicago and New York.

Mr. Blough was appointed in 1944 to his present position as Director of Research of the American Institute of Certified Public Accountants. He has been a member of the Institute since 1929 and has served on many of its important committees, including the Committtee on Accounting Procedure. He has been President of the American Accounting Association. He is the author of many technical articles and editor of a department in *The Journal of Accountancy*. He is the author of the book *Practical Applications of Accounting Standards* published by the American Institute in 1957.

For his outstanding achievements in the accounting profession, Mr. Blough was honored with an American Institute of Certified Public Accountants Distinguished Service Award in 1953 and was named to The Ohio State University's Accounting Hall of Fame in 1954. He received the Alpha Kappa Psi Award from the American Accounting Association in 1955. In 1957 he was honored as guest speaker at the seventh International Accounting Congress in Amsterdam, The Netherlands, and at the First National Accountants Conference at Ankara, in Turkey.

We now bring you Mr. Carman Blough, who will talk to us on the subject, "Accounting Research for Better Financial Reporting." Mr. Blough.

ACCOUNTING RESEARCH FOR BETTER FINANCIAL REPORTING

CARMAN G. BLOUGH
Director of Research
American Institute of Certified Public Accountants
New York, New York

We all recognize that new inventions are all around us, new products of many kinds are being created, new machinery and equipment are being developed to make new products and to improve on the production of old ones, and automation has become part of the everyday language of business. Atomic energy and electronic devices are adding vast new areas of business activity.

By the application of electronic computers to the problems of accounting, the possibilities of recording, classifying, analyzing, and reporting have already been developed far beyond our wildest dreams of only a few years ago, and the end is still beyond our imagination.

In addition to all of these technological changes have come changes in our economy—greater governmental controls, subsidies, inflation, labor influences, increased international relations, diversification, expansions, corporate mergers and acquisitions, and a host of others.

While changes are nothing new in modern industrial life, there seems to have been an acceleration of them in recent years. Accordingly, it seems obvious that accounting will have to continue to adapt itself to changes for a long time to come. While this adaptation is of concern to all accountants, it is probably of the greatest concern to the independent CPAs. It would seem natural, therefore, that they should assume the leadership in adapting financial accounting and reporting to new conditions as they arise. It is they who are most vitally interested, as accountants, in the fairness and consistency of the financial reports of *many* businesses. They have more opportunity to study the problems as they arise in numerous, varying circumstances than anyone else. No business executive has an opportunity to see so many examples. University teachers and government officials seldom have the opportunity to get so close to the problems.

It seems only natural, therefore, that the American Institute of Certified Public Accountants (which I shall refer to as the Institute), as the principal spokesman for the independent CPAs, should have undertaken years ago to try to develop and improve those phases of accounting that are most important in the field of financial reporting. Progress has been made but much remains to do. What are the steps that should be taken?

Some seem to believe that uniformity of accounting principles and procedures is what is most needed; that rules should be established in such detail that similar transactions would always be handled similarly in the accounts. Comparability is their goal. Others believe that such uniformity would be impossible but firmly believe that much more uniformity than we now have would not only be possible but highly desirable. Still others consider uniformity to be highly dangerous. To them, subjective judgment in each case should govern; they believe consistency, accompanied by disclosure, is of primary importance.

Some lay great stress on the need to change accounting principles to give complete effect to changing price levels, while others would be content to change them only with respect to depreciation, and still others would make no change.

Some think tax rules have too much influence in establishing accounting principles while others would conform accounting more nearly to the requirements of the tax laws.

Some believe there are accounting principles that are unchanging, as are natural laws, while others consider them to be devices to be adapted to meet current business problems. Some think accounting principles are distinguishable from accounting procedure while others consider them the same.

Some believe a single set of financial statements should serve all users while others believe different statements should be prepared for different users.

Some believe that, in reports to creditors and stockholders, publicly regulated companies should follow accounting principles generally accepted for unregulated companies if the auditor is to express an unqualified opinion, while others believe the regulatory accounting requirements should be considered by the auditor to be generally accepted accounting principles for such companies. And so on, ad infinitum.

In our modern life, research is playing an increasingly important part. Vast sums are being spent for it—in business, education, politics, government, and even in religion. Possibly it is only natural then that we accountants hope that the answers to our own problems may be found through this medium.

Ever since the establishment of the Research Department in the American Institute of Certified Public Accountants in the early part of 1939, its officials, members of its staff, and members of the committee on accounting procedure have often been asked what is meant by the term "research" in the field of accounting. My own answer is that it means just what the dictionary says it means. The first definition of the word "research" in my dictionary reads "diligent, protracted investigation, especially for the purpose of adding to human knowledge; studious inquiry."

In the field of accounting principles and procedures, such investigations and inquiries cannot be directed primarily to the literature in the field. Accounting has been defined by the Institute's terminology committee, as "the art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the results thereof." In harmony with this definition, accounting research is directed toward an understanding of the accounting needs of all segments of business, the methods that have been tried to meet them, the development of possible alternatives, the arraying of possible arguments for and against the different proposals, the gathering together and analyzing of the viewpoints of others—all with a view to determining which alternative would be most useful.

The primary function of the certified public accountant, certainly the one which justifies his certification by the state, is that of issuing independent opinions with respect to financial statements. As a result, the researches in accounting by the Institute have been, and I have no doubt will continue to be, devoted to the area of financial reporting. This does not represent any lack of interest in the usefulness of accounting for management and internal control or a failure to recognize that many of its members are primarily interested in those phases of accounting. Instead it stems from a recognition of the limitation of the areas which any group can reasonably expect to cover, together with the realization that effective organizations, such as the Controllers Institute of America, the National Association of Accountants, and the Institute of Internal Auditors, are devoting their primary interests to such areas.

Two years ago, at the twentieth meeting of this Ohio State University Institute on Accounting, Mr. Alvin R. Jennings, then the President of the American Institute of Certified Public Accountants, pointed out the lack of distinction between accounting principles and accounting procedures that has existed for many years, and decried the wide latitude of choices of methods which has brought much criticism toward financial representations. He traced briefly the steps that had been taken by committees of the American Institute to narrow the areas of difference in Corporate accounting, emphasized his belief in the need for more research, and reported the steps which he had taken as President of the Institute to set in motion the development of a greater research program.

In discussing this phase of the subject, I should like to take up where Mr. Jennings left off. In closing his remarks two years ago, he spoke briefly about his appointment of a special committee to restudy the whole subject of accounting research and some of the things which he hoped a new approach might accomplish. He reported that the special committee had filed a progress report with the Council of the Institute at its 1958 Spring meeting which he appraised as most encouraging.

That special committee made its final report to the Council at the time of the annual meeing of the Institute in Detroit in the fall of 1958. The recommendations contained in that report were taken under advisement by the Council until the Spring meeting in April 1959, at which time substantially all of them were approved. The program, as approved, brought about the creation of an accounting principles board and a new division in the staff known as the Accounting Research Division.

At the time the accounting principles board came into existence on September 1, 1959, the committee on accounting procedure, which had been in existence in its most recent form since 1938, went out of existence. The charter for this new board provides that it "shall have the authority and the duty to issue, in its own name, pronouncements on accounting principles" and " may in its discretion, revise or revoke, in whole or in part, or issue interpretive statements as to pronouncements previously issued." The board is to issue pronouncements only when two-thirds of its members approve.

At first blush, there seems to be little difference between the old committee of twenty-one members and the new board of eighteen. However, there are significant differences in the methods of their appointment, the terms of office of their members, and their methods of operation which, it is hoped, will make notable differences in their results.

The members of the committee on accounting procedure were appointed from year to year by the President, whereas the members of the accounting principles board are nominated by the executive committee and elected by Council. It is anticipated that this will give the board even greater stature than was accorded the committee on accounting procedure. The membership of the first appointed board was divided into three groups, six to hold office for one year, six to hold office for two years, and six to hold office for three years. Subsequently, except for appointments to fill vacancies, six persons will be elected each year to serve for a period of three years each. Members may succeed themselves. At the meeting of Council early this month, those first elected for one year were renominated and reelected to succeed themselves for a three-year term beginning September 1, 1960.

A fiscal committee, composed of three members of the board designated by the executive committee of the Institute, is set up to supervise the fiscal administration of the Accounting Research Division.

The Accounting Research Division is headed by a Director of Accounting Research, nominated by the fiscal committee of the board and approved by the executive committee of the Institute. Dr. Maurice Moonitz, presently Professor of Accounting at the University of California at Berkeley, has been appointed the first Director of Accounting Research. He will take office on July 1 of his year. Dr. Perry Mason, who has been with us at the Institute for the past six years, is the Acting Director and will continue as Associate Director after Dr. Moonitz takes over.

It is contemplated that the Director will have a full-time staff of about five persons well qualified to do accounting research. The plan provides that this research staff shall work exclusively in the field of accounting principles and procedures. It is also planned that others may be retained from time to time for special research projects.

This staff, which is to devote its energies exclusively to research in the field of accounting principles and procedures, is another of the changes which it is hoped will produce a significant difference in the results to be accomplished by the accounting principles board as compared with those of the accounting procedure committee. In its early years, the old Research Department, now the Technical Services Division, which was set up by authority of the Council to serve the accounting procedure committee, had as many as three and occasionally four full-time men doing so. However, as the work of that Department expanded and it was required to service more and more technical committees, it became impossible to allocate even the equivalent of one man's full time to the work of the committee on accounting procedure. The inevitable result was that more and more of the load fell on the members of the committee until it became the burden Mr. Jennings described here two years ago.

Sound conclusions on matters of accounting principle can only follow careful and extensive study. It is hoped that the development of a strong research staff, devoted exclusively to the problems of significance to the board, will make it possible for the board to reach sound decisions more quickly.

Since this concentrated effort on the part of the accounting research staff is intended to make the new program significantly more effective than was that of the committee on accounting procedure with the assistance of the former Research Department, it may be appropriate to describe how the Accounting Research Division is to function.

It is expected that the Director of Accounting Research and his staff will make extensive studies in the areas that seem to be of special importance in the field of accounting principles and procedures. The Director and the chairman of the accounting principles board will be jointly responsible for the selection of the areas to be studied. The board itself is also expected to designate areas in which it wishes the staff to conduct research.

An advisory committee, usually of five or six persons selected by the Director with the approval of the chairman of the board, is to be set up for each subject that is to be studied. At least one member of each advisory committee, who will act as its chairman, will be a member of the board. It is contemplated that this advisory committee will be composed of persons especially competent in the particular area, some of whom may not be members of the board and some, not even accountants. For example, to date an economist is on one such advisory committee, lawyers are on two others, and a financial analyst is on a fourth.

The areas to be studied are to be widely announced, and all interested persons will be invited to submit any information or arguments which they consider pertinent to the subject. When the research has been completed, it is contemplated that an "Accounting Research Study" will be printed and distributed widely. According to the plan, each of these studies will contain comprehensive statements of the problems, the facts involved, and the pros and cons of the various proposals that have been considered during the course of its preparation. The Director of Accounting Research may, and probably usually will, make a recommendation as to what he considers to be the proper conclusion, but his opinion is not to carry any Institute authority and is not to be attributed in any way to the board.

Upon the completion of one of these accounting research studies, the accounting principles board is expected to decide whether it should issue a formal statement of its own with respect to that subject matter. If it decides to do so, an announcement to that effect will be issued and an opportunity given to all interested parties to file briefs, memoranda, or arguments of any kind that they may wish to submit to help the board reach a final conclusion.

By this procedure, the members of the profession, and any others interested, will have a more thorough understanding of the factors considered by this board than has been true with respect to the statements of the committee on accounting procedure.

In fairness to the committee on accounting procedure, however, it should be pointed out that it had not overlooked the interest which other accountants had in what it was doing. It also had developed procedures for bringing the viewpoints of others to bear on the committee's thinking in the course of the development of its conclusions as finally set forth in the accounting research bulletins, but not to the extent called for under the new program.

Although there is nothing in the new program which would require greater recognition of the proposed statements on accounting principles by the board than was accorded the bulletins of the accounting procedure committee, with the greater formality of the appointment of the members of the board, with the publication of the accounting research studies, and with the expanded program for public participation, it is anticipated that they will carry greater force. It was also the special committee's earnest hope that, once the program got under way, there would be many more critical areas covered in a period of a year than it has been possible for the committee on accounting procedure to bring to a conclusion, and that the statements of the board would be considered to be the highest authority on the subjects they cover.

Another innovation that has been included in the new program is the plan for the issuance by the board of interpretive rulings. The committee on accounting procedure, with only one exception, left the interpretation of its bulletins to the readers, although members of the staff often expressed their own opinions as to what was intended, and sometimes members of the committee gave the staff the informal benefit of their own views. The new program provides for the submission to the board of any interpretive answers given by the staff to questions relating to the statements by the board if the Director of Accounting Research thinks they are significant. The board is then expected to consider the matter and, if it thinks the question has sufficient importance, issue an Interpretive Ruling. Such rulings are to be published in numbered form in such a way as to be useful as ready references and will carry the full authority of the board.

The accounting principles board has had two meetings to date, both of which have been devoted largely to organizational matters and the selection of subjects for research by the staff. It will hold its third meeting tomorrow, May 20th in New York, at which it is expected that a number of matters of major policy will be considered.

Perry Mason, the Acting Director of Accounting Research, has been very actively attempting to recruit qualified research personnel. He has now employed two research assistants, one of whom will join the staff on July 1, while the other will report for duty on September 1. Both of these assistants will have completed their residence requirements for the Ph.D. degree and one will likely receive it before joining the staff. In the meantime, Dr. Mason has managed to get studies under way on six different subjects.

When the special committee on research program made its recommendations to Council, it included the recommendation that the first studies to be undertaken should be the development of a statement of basic accounting postulates and a statement of broad accounting principles. The special committee thought that statements by the board on these subjects should precede any other statements and that all subsequent statements should be based on them. That is a big order and one which is more easily issued than executed.

Professor Moonitz has elected to head up and begin the study of these two areas before he actually takes over as Director of Accounting Research. Professor Robert T. Sprouse, one of Professor Moonitz' associates at the University of California at Berkeley, will assist in both of these projects.

Four other subjects have been selected for study, and work has begun on them. Professor Homer A. Black of Florida State University has undertaken to study "Accounting for Income Taxes." This involves a study of all phases of the subject such as income tax allocation, income taxes as expenses, and loss carrybacks and carryforwards.

Professor John H. Myers of Northwestern University has undertaken to head up the study of long-term leases. This will cover not only long-term leases of real estate but the whole problem of sale and lease back of productive facilities and the lease of machinery and equipment, both from the standpoint of the lessor and of the lessee.

Professor Arthur R. Wyatt of the University of Illinois has assumed responsibility for the study of business combinations. This will include a study of such combinations as purchases of business units, statutory mergers, and pooling of interests.

Professor Emerson O. Henke of Baylor University has agreed to direct the study of accounting for nonprofit organizations. This is designed to develop a statement of accounting principles for nonprofit entities, such as religious, charitable, scientific, educational, recreational, governmental, and similar types of organizations.

Eyebrows have been raised over the fact that all of the members of the staff that have been employed for the new accounting research division and all of the persons to whom research studies have been assigned to date have devoted most of their professional lives to educational pursuits. The question has been asked why persons with substantial experience in either corporate or public accounting have not been obtained for these responsibilites. In other words, the question seems to be whether the results of the research studies under these conditions may not prove to be too theoretical to be truly effective from a practical standpoint.

While this is a question which can be answered only after a great deal more water has gone under the bridge, a number of answers have been given by those who have been responsible for the selection of the personnel involved. The first is that after diligent search and wide inquiry among members of the profession, no well qualified persons with substantial practical experience could be found who would undertake the work, either on a full-time basis or for a special project. In view of the competition among employers for persons with substantial practical experience who are also capable of making research studies of this kind, this is not surprising. On the other hand, this type of work constitutes a real challenge to one who has been devoting most of his activities toward educational projects. Combine this challenge with the somewhat less severe competition in the educational field and the Institute's invitation becomes more attractive. As for the special projects, university teaching clearly adapts itself much better to undertaking a part-time research project than does employment with a business or a professional firm.

A second point is that there are techniques in the conduct of research which persons with advanced scholastic training have had to learn in order to earn their degrees but which either may never have been used by persons in other lines of endeavor or which may have been used so long in the past that they have been forgotten.

The third reason, and the one which is relied upon to assure the proper mixture of the practical with the theoretical, is the fact that each of the research projects is to have the benefit of an advisory committee. It is expected that these advisory committees will be made up of persons who will be able to help the most theoretical researcher from getting too far into the stratosphere.

You may notice that three of the subjects on which research studies have begun—income taxes, long-term leases, and business combinations—have previously been covered by accounting research bulletins issued by the committee on accounting procedure and you may wonder why the new board feels called upon to reconsider them so soon. Before the old committee was scheduled for extinction, it had decided that there were major gaps and some important weaknesses in the bulletins dealing with these subjects and had put them on its own agenda for further consideration. When it went out of existence, the committee on accounting procedure recommended to the accounting principles board that these subjects be given early consideration by it.

The subject of accounting for nonprofit organizations had been under consideration by the committee on accounting for nonprofit organizations for a number of years. At the second meeting of the board, that committee submitted a proposed statement on the subject with the request that the board approve its release for comment and criticism. Instead, the board decided that the subject was of such importance that it should be thoroughly studied by the research staff before anything is published with respect to it. Accordingly, release of the proposed statement by the committee on accounting for nonprofit organizations was deferred at least until the research staff has completed its study. At that time, the board will decide whether to release the statement, refer the matter back to the committee on accounting for nonprofit organizations, or issue a statement of its own.

A number of other subjects for early research have already been suggested by individual members of the board, and some of them will undoubtedly be approved in the near future. Among them are "Treatment of Fifty-percent-owned Companies," "Research, Exploratory and Development Costs," "Accounting Adjustments for Price-level Changes," and a reconsideration of the bulletins on "Accounting for Pension Costs." The areas of difference are many and they continue to develop. Possibly, if we run real fast, we may be able to keep from falling further back.

CHAIRMAN ARNOLD: Mr. Blough, I want to thank you for the wonderful presentation which you have just made. It is a pleasure and a rewarding experience to have you with us at any time.

Mr. John Peoples, our next speaker, was born in Northern Ireland where he received his early accounting education. He came to the United States in 1929 and joined the staff of Peat, Marwick, Mitchell and Company, where he heads the firm's department of Professional Practice. For a number of years Mr. Peoples was a member of the American Institute of Certified Public Accountants committee on Accounting Procedures. He is a member of the New York State Board of Public Accounting Examiners; a Certified Public Accountant of New York and a number of other states; and is a chartered accountant of Ireland and Canada.

Mr. Peoples will talk to us on the subject, "Changes in Auditing Procedures in an Expanding Economy." Mr. Peoples.

CHANGES IN AUDITING PROCEDURES IN AN EXPANDING ECONOMY

JOHN PEOPLES
Partner, Peat, Marwick, Mitchell & Co.
New York, New York

The world today is a very different place from what it was 60 or 70 years ago when public accounting was beginning to emerge as a profession, though I doubt if many people at that time would have considered the public accountant as a professional man.

Change in the purpose of an audit

To what extent has the auditor changed his procedures in this expanding economy? Over the years his primary responsibility has shifted. Certainly in the early days it was the detection of fraud, and while today this is not entirely ignored, it is incidental to the main purpose of reporting on financial statements. Indeed the emphasis has shifted to the point that many firms today have the client acknowledge in writing that the test examination which has been carried out would not necessarily disclose irregularities should any exist. Mr. Jones will have a lot more to say on this later in the morning.

The shift in emphasis on the primary responsibility, so far as I can tell, goes back more than 40 years when Mr. Montgomery brought out his first edition of *Auditing*. He had previously published, in 1905 and 1909, American Editions of Dicksees' work on auditing. When he came to write his own book in 1912 he felt that the detection of fraud, which at one time had been the chief object of an audit, must be relegated to a subordinate position without in any way depreciating its importance. He added that financiers and businessmen who originally retained professional auditors to look for fraud or errors have enlarged their demands and now require a vastly broader and more important class of work in connection with the ascertainment of financial condition and earnings of an enterprise.

Mr. Montgomery was very advanced in his views for the times. His suggested procedures represented a substantial departure from the practices advocated by English writers, which up to that time had been more or less the only authors on auditing available in the United States. More than 40 years later the authors of the 8th edition of *Montgomery's Auditing* have moved still further from detail checking. In the preface they state that:

"Most clients will agree that, with respect to examinations incident to the issuance of opinions regarding financial statements, it is unnecessary for independent public accountants to make, and expect to be paid for, extended tests of cash receipts, disbursements, and vouchers undertaken for the sole purpose of detecting possible defalcations and other similar irregularities and which are not required to enable the auditor to express his opinion. Oddly enough, it continues to be difficult for some independent public accountants to accept this viewpoint; and they continue to make extended tests and reviews of details of cash receipts, disbursments, vouchers, etc., in the firm belief that, whether the client wants it or not, or whether the system of internal accounting control and internal check warrants the work, they should continue to perform such detailed and expensive tasks."

This gradual shift in viewpoint as to the purpose of an audit is the position of the profession as a whole as the *Codification of Statements on Auditing Procedure*, published in 1951, states that:

"The ordinary examination incident to the issuance of an opinion respecting financial statements is not designed and cannot be relied upon to disclose defalcations and other similar irregularities, although their discovery frequently results."

With the shift in emphasis as to the purpose of an audit, there has been a corresponding change in audit procedures with the result that, at least in the well-organized company, the test of the day-to-day transactions is very limited and is basically to see that the system of internal control is operating effectively. While the groundwork for the change was laid many years ago, the procedures were not revised overnight, and in my own lifetime I have seen a substantial curtailment in the amount of detail checking considered necessary, an increased emphasis on inquiry into the system of internal check and on the importance of advising the client of any weakness in the system. This may be regarded as routine by the younger accountants, but it is perhaps the major change in auditing procedures in the modern history of the profession.

Extended auditing procedures

During this period of gradual change there were two significant procedures adopted by the profession as a whole. While observation of physical inventories and confirmation of receivables by correspondence was not unusual, these procedures were not recognized as required by generally accepted auditing standards prior to 1939. In that year, largely as a result of the McKesson & Robbins case and the resulting hearing by the Securities and Exchange Commission, the membership of the Institute approved the extension of auditing procedures to require observation of inventories and confirmation of receivables where either of these assets represents a significant proportion of the current assets or of the total assets of a concern. In 1956 the Committee on Auditing Procedure put further emphasis on these procedures when it expressed the opinion:

> "That in all cases in which the extended procedures are not carried out with respect to inventories or receivables as at the end of the period or year and they are a material factor, the independent certified public accountant should not only disclose, in the general scope section of his report, whether short or long form, the omission of the procedures, regardless of whether or not they are practicable and reasonable, but also should state that he has satisfied himself by means of other auditing procedures if he intends to express an unqualified opinion."

Work spread throughout the year

The increased reliance on internal control, the application of extended auditing procedures, and the increased emphasis on the income statement has permitted the auditor to perform a substantial part of his examination prior to the end of the fiscal year. While this is not so much a change in procedure as a change in their timing, it is one of those significant departures from previous practice which should not go unnoticed.

The public accounting profession will always be somewhat seasonal when a majority of companies end their year on December 31. It is not so long ago that a substantial part of the staffs of public accounting firms in the first three months of the year were temporary men. Today this is a thing of the past in a well-organized firm.

Obviously the kind of man needed in the profession would not accept temporary employment and the existence of this kind of work did not encourage good men to enter the ranks of the profession. The long years of the depression did nothing to speed the change but with the man-power shortage in World War II the Institute's Committee on Auditing Procedure did suggest to the New York Stock Exchange that they could see no way to alleviate the situation except by either curtailing the work done, through relaxation of auditing standards, or by spreading the work more evenly during the year. The Committee, of course, emphasized that any relaxation of auditing standards was not desirable and the Stock Exchange agreed.

This was in 1942 and at that time the Committe encouraged the undertaking of as much work as possible before the year end, particularly on the review of internal control, the examination of inventories and the confirmation of receivables. More has been done in the intervening years to spread the work load, and in certain situations it should be possible to do most of the work before the year end. Some of the prerequisite conditions are as follows:

1. Long enough association with the client to develop a sense of confidence based on audits
2. A good system of internal control
3. Competent personnel on the client's staff
4. Good internal reports
5. A reasonably stable pattern of operation in the last quarter.

In these circumstances there is no reason why the company should not take inventory as early as, say, September 30 and that most of the audit procedures should not be completed before December 31. After the close of the year the major bank accounts and certain liability accounts could be confirmed but the principal reliance would be placed on the audit steps relating to the September 30 balance sheet supplemented by an analytical review of the operation of the subsequent three months.

Statistical sampling

Now let us look at a new application of an old technique, which perhaps has had more publicity in the accounting journals than actual practice as an auditing procedure. I am referring to statistical sampling.

Sampling or testing has long been the approach of the auditor to his examination of accounting data. Recently there has been some suggestion that the approach has not been entirely scientific. Statisticians have tended to be critical of the auditing profession regarding the manner in which sample size, items to be tested, and the results of tests are evaluated by the profession at the present time. They infer that perhaps the auditor is not justified in drawing conclusions on the basis of his present unscientific approach. As one statistician put it, "The auditor has been playing the statistician's game for a long time but has refused to abide by the rules of the game." On the other hand, the statistician, except in rare instances, does not and should not be expected to be familiar with auditing techniques nor to appreciate the extent to which we rely on internal control. Each examination is not separate in itself and to some extent we rely on our findings in previous years, for after all, conditions do not change overnight. If the statistician criticizes the auditor because he feels the size of the sample is too small it may be because he does not realize that many of our tests are related. Our observation of inventory counts may be relatively small because we have additional assurances of the physical existence of the inventory from the tags showing a count and perhaps a recount, the pricing sheet and probably the perpetual inventory records. Our analysis of departmental results in comparison with previous periods lends further assurances on the inventory and we may have additional support for our conclusions in the evidence developed through standard costs and budgets.

Generally the benefits which have been cited for the statistical approach have been:

1. Better control over selection of items being tested.
2. A determination on a mathematical basis of the amount of testing which should be done.
3. Evaluation on a mathematical basis of the results of the tests.

Statistical sampling involves four distinct stages:

1. The design process—the auditor and the statistician jointly develop the principles to be used in selecting the sample.
2. Drawing of the random sample.
3. Statistical evaluation—at this point the sampling results are mathematically analyzed.
4. Decision by the auditor—he has the responsibility for deciding whether the situation disclosed by the sample is acceptable or not.

It is in the manner of sample selection where the auditor can learn the most from the statisticians' methods. Statisticians place great emphasis on the random selection of items to be tested. By random, they mean that each item in the field has an equal chance to be selected. The methods which are suggested in order to obtain randomness or near randomness are:

1. Use of random numbers.
2. Systematic selection.

Random number tables have been published and are available in many forms. A list of numbers is selected from the random number tables corresponding to the number of items to be included in the sample. If the vouchers to be tested consisted of 5 digits, then you would select 5-digit numbers. After selecting the random numbers, they are arranged in numerical order and the items to be tested are drawn. In order to use this method of sample selection, it is necessary that the field must be numbered at the time the transaction is recorded or subsequently when the test is made. The other method of sample selection is the systematic approach. This consists of selecting items at regular intervals through the field. Actually this method has been in use by many auditors for some time. When this method is used, care should be exercised that there is no cyclical arrangement in the field to be tested; e.g., if you were performing a payroll test and selecting every tenth name for checking the detail of the pay computation and it should happen that every tenth man was a foreman or subforeman, then you would only be testing the foreman's pay. Therefore, if there may be a cyclical arrangement, it would be desirable to change the interval several times during the selection. When a sample is selected which is not representative of the field, it is said to contain bias. The payroll example above is a good example of a biased sample.

The use of either of the above methods would be a definite improvement in the sample selection methods which are being used in some cases at the present time. However, it should be understood that if the auditor has a particular reason to wish to examine certain items, these methods should not preclude his subjective judgement of selecting certain transactions. It is quite usual for auditors to place more stress on the larger dollar transactions since they feel that if they examine a large percentage of these and a lesser percentage of the small dollar transactions, they can be reasonably satisfied. The statistician calls this stratifying the field and agrees that this is a sensible approach.

While statistical sampling including the determination of sample size, is certainly not an auditing technique of wide application, it would appear to be useful in larger engagements in which there is a mass of detailed transactions of a relatively similar dollar amount. Some examples of these would be:

1. Inventories which contain extensive amounts of parts or similar items.
2. Acccounts receivable for department stores or public utilities.
3. Depositors' accounts in banks and savings and loan associations.
4. Loss claims and loss claim reserves in insurance companies.
5. Test counts of trust and safe keeping securities in banks and trust companies.

In addition, clients are, and will be, adopting these methods within their organization in order to save clerical work. The use by clients will necessitate an evaluation of these methods by the auditor when he is ascertaining the adequacy of the system of internal control. Care will have to be taken that the clients' methods do not weaken the existing internal control. Some examples of where business organizations have employed these methods are:

1. To cut down on the amount of rechecking of payroll and sales transactions.
2. To count physical inventories.
3. To age accounts receivables.

It is probable that statistical sampling is not going to revolutionize auditing. However, it is obvious that with the upgrading of the profession and the increase in rates, we must use every tool that will result in greater efficiency. Statistical sampling clearly has its place in auditing procedures and the need to explore its possibilities in this connection is the responsibility of the profession rather than the statistician.

Impact of punched card equipment on auditing procedures

Since the end of World War II there has been a substantial increase in the commercial use of punched card equipment to aid in accounting routines. Today many business firms are leasing or purchasing punched card equipment. Some of the smaller firms are utilizing tabulating service bureaus.

Despite the rapid growth in punched card accounting in the last decade, auditors generally have not taken full advantage of this equipment in conducting their examinations.

Auditors are in agreement that the principles by which they are governed and the responsibilities undertaken are in no way changed when the client changes from manually prepared records to tabulated records. Mechanization, however, has created new problems in methods of performing various audit procedures.

With a manual bookkeeping system, the auditor is able to follow transactions from the supporting evidence to their recording in the books of original entry. From there, each summary posting may be traced to the general ledger. The auditor is thereby assured that each transaction is properly recorded in the general ledger.

The auditor's task of verifying clerical accuracy and proper classifications by manual methods becomes very time consuming, however, in instances where the company has installed punched card equipment because of the volume of transactions handled. In such cases the auditor should consider utilizing the equipment to assist him in performance of various audit functions. The use of the punched card equipment by the auditor will not greatly effect the nature of his current auditing procedures, but rather the methods of applying these procedures through utilization of the machines to accomplish the clerical functions inherent in some of the audit procedures. The vouching of detailed transactions to source documents, for example, is not directly affected.

Examples of special time-consuming audit procedures where punched card equipment may aid auditors are:

1. Listing of accounts receivable for confirmation requests.
2. Preparation of confirmation requests.
3. Aging of accounts receivable.
4. Inventory compilation and verification of footings and extensions.
5. Analysis of accounts such as properties and certain expenses.
6. Listing and footing of accounts payable.
7. Analysis and check of clerical accuracy of special reserves and accruals involving voluminous detailed items.
8. Verification of payroll extensions and footings.

Before the auditor can consider designing effective procedures, he must first obtain an understanding of the client's punched card accounting system. At this time the auditor should obtain an understanding of the various mechanized accounting functions by constructing condensed flow charts, examining business forms and reports to be used, becoming familiar with permanently wired boards, card columns of selected cards, etc.

Before programming the audit, the accountant should review internal control procedures relating to punched card equipment. Examples of good internal control procedures are:

1. Operation of punched card equipment independent of other departments.
2. Segregation of duties within the tab department.
3. Built-in machine checks to:
   - Verify accuracy of punching cards.
   - Tie-up of amounts with controls during processing.
   - Account for numbers of documents or papers.
4. Independence of check-signing operations and control of blank checks.
5. Observations and comparisons by separate control groups.
6. An internal audit department which makes adequate verification of tabulated records.

The extent of audit tests of tabulated records should be based on the degree of internal control in a manner similar to the auditing of manual records.

In using the equipment, it is necessary for the auditor to control its operation by doing one or both of the following:

1. Utilizing a "test deck" (including all conceivable transactions) and observing the run of such cards to determine that resulting information and amounts and classifications are in agreement with data previously determined manually.
2. Although in the usual case the auditor will generally rely on the test deck approach, he or an associate may be sufficiently familiar with tabulating equipment to place reliance on an inspection of the board wiring. In some cases it might even be desirable for the auditor or consultant to wire the board himself.

The procedures of using a "test deck" and/or inspection of the wiring are deemed necessary, not only to assure that nonintentional machine errors and planned manipulation of listed totals, classifications, etc., are discovered by the auditors, but that the machine operation has been properly programmed or "wired" to do the job intended.

After checking equipment by running the "test deck" and/or inspecting the board wiring, the run of cards through the tab machine should be observed and the resulting report properly controlled.

Conclusion

Recently a representative of one of the companies selling electronic data processing equipment suggested to the Chairman of one of our clients that the day may not be far distant when each morning it would be possible to project on a screen the essential operating data of the previous day and the results to date.

If the day comes, and nothing would surprise us in this age, it will simply be an extension of what we have already seen in the use of tabulating equipment and electronic data processing, though there may be greater application of the processing to relatively small business through the wider use of service bureaus. The auditor will still continue to inspect basic documents (checks, invoices, etc.) but the trail between the basic documents and the end result will not be as obvious as it is today. In fact, the trail has already changed in the case of tabulating equipment and still more in the case of electronic data processing.

While it may be possible for the auditor to obtain a printed record of those transactions which he wishes to check, it would seem essential that he have a working knowledge of the equipment and the internal control over the department in which it operates. The procedures adopted by the auditor may change somewhat but the qualities he needs of integrity, independence, and ability will remain unchanged. Nor is it likely that in a free society an impartial opinion on the fairness of financial statements will no longer be required.

CHAIRMAN ARNOLD: Mr. Peoples' thoughts on the changes necessary in our ever expanding economy have been provocative and enlightening. We thank you, Mr. Peoples.

Our next speaker on this morning's program is Mr. Ralph S. Johns, partner, Haskins and Sells, Chicago. Mr. Johns is a graduate of the University of Illinois, B.S., with high honors, and M.S. He holds Certified Public Accountant certificates in Illinois, New Jersey, New York, Iowa and Wisconsin.

Mr. Johns is a member of the American Accounting Association, a former council member of the American Institute of Certified Public Accountants; past President of the Association of Certified Public Accountants Examiners; former member of the Board of Directors of the Illinois Society of Certified Public Accountants; past President of the New Jersey Society of Certified Public Accountants; a member of the New York State Society of Certified Public Accountants; present Chairman of the Certified Public Accountants Examination Appraisal Commission; also Committee Chairman of the Illinois Society of Certified Public Accountants on Cooperation with the Illinois Securities Commission and Stock Exchanges.

He is the author of several accounting articles, including the *Allocation of Income Taxes*, *College and University Accounting*, and *The Natural Business Year*. He was co-author of *Auditing* (3rd edition) by Bell and Johns. He was co-author of Palmer and Bell's *Accountants Work Papers* (3rd edition).

Mr. Johns is also a member of the Board of Directors and Treasurer of the Union League Club of Chicago; a member of Trustees and Vice President of the Union League Foundation for Boys' Clubs, Inc.; a special consultant to the Committee on Accounting and Business Practices of the American Hospital Association; and former member and chairman of the Board of Examiners in Accountancy for the State of Illinois.

It is a pleasure for me to introduce to you Mr. Ralph Johns, who has as his subject this morning, "Accountant's Responsibility for Disclosure of Irregularities."

(Not recorded)

CHAIRMAN ARNOLD: Ralph, it has been a pleasure to have you with us this morning, and I am certain that all of us will face up to our responsibilities as you have outlined them. We are only sorry that you did not desire your talk recorded for publication. Thank you, Mr. Johns.

This brings to a close our first session of the Institute on Accounting. I wish on behalf of The Ohio State University and myself to thank the audience for their participation, and also to thank again the speakers for their learned talks.

SECOND SESSION

THURSDAY, MAY 19, 12:30 P. M.
The Ohio Union—East Ballroom

Presiding:

ROBERT A. DRAPER, *President, the Ohio Society of CPAs; Partner, Konopak & Dalton, Toledo, Ohio*

Presentation of the Ohio Society of CPA awards to the highest candidates in the Fall 1959 CPA examination, made by:

WILLIAM SCHMELTZ, *Chairman, Committee on Accounting Education, Ohio Society of Certified Public Accountants; Chairman, Department of Accounting, Bowling Green State University, Bowling Green, Ohio.*

SECOND SESSION

CHAIRMAN ROBERT A. DRAPER: Ladies and gentlemen, will everyone please stand?

Almighty and eternal God, Who has given us the privilege of serving Thee, may we always be equal to our opportunities. Make us aware of Thy presence, and give us joy in service. Inspire our hearts that we may help and respect our fellow men, and inspire our thoughts that we may glorify Thee. Amen.

Ladies and gentlemen. Welcome to this first luncheon session of the twenty-second annual Ohio State University Institute on Accounting.

It has been traditional at these Institute luncheons to recognize the Ohio Society of CPAs. On behalf of the Ohio Society, I want to say that we certainly appreciate the honor, and we are proud to have a part in your program. As you know, our members have always demonstrated by their attendance that they are strong supporters of the Institute.

Of course, I am personally very proud to preside on behalf of the Ohio Society and I want to take this opportunity to congratulate The Ohio State University, and in particular Dean Jim McCoy, the Accounting Department Chairman Paul Fertig, and his faculty, who make this possible.

Being a midwesterner by birth, and coming from Dartmouth with an enrollment of under 3,000, and Tufts School of Business with an enrollment of 200, I used to be constantly amazed that you at The Ohio State University could keep stirring up such a large batch of education without screwing up the ingredients. It does not amaze me any more. We expect a quality product from Ohio State and let me tell you there is a brisk demand. We found out.

Now, for 22 years you have been turning out an outstanding Institute. After this morning's sample, even those of you who were here for the first time know what I mean, and will agree with me.

This noon I have three pleasant functions to perform, and I will get with it right now. First, it is my honor to introduce some of the many splendored things at the head table. It will not be possible to mention all of their splendors—just their current ones. I am going to start at the Toledo end, north, and work my way south. Please hold your applause until I have completed the introductions.

At the north end, the Executive Secretary of The Ohio Society of CPAs, Robert R. Bangham; next, Professor of Business Administration, Harvard University, Boston, Massachusetts, and a speaker at this afternoon's session, Robert N. Anthony; Vice President of the Ohio Society of CPAs and Partner, Keller, Kirschner, Martin and Clinger, Columbus, Ohio, Leonard L. Hopkins; then President of the National Association of Accountants, Manager of Finance for the Small Aircraft Engineering Department of General Electric Company, West Lynn, Massachusetts, who will preside at this afternoon's session, Leslie I. Asher; President-elect of The Ohio Society of CPAs and partner of Thayer, Kleines and Company, Akron, Ohio, James E. Thayer; partner, Haskins and Sells, Chicago, Illinois, and a speaker at this morning's session, Ralph Johns; partner of Peat, Marwick, Mitchell and Company of New York, and another speaker at this morning's session, John Peoples; Vice President of The American Institute of Certified Public Accountants, partner of Arnold, Hawk and Cuthbertson, Dayton, who presidend at this morning's session, Frank L. Arnold.

Now on the south side of me, immediate Past President of The Ohio Society of CPAs, and currently a member of the council of the American Institute of Certified Public Accountants, partner of Battelle and Battelle, Dayton, Ohio, Gordon S. Battelle; Research Director of the American Institute of Certified Public Accountants, New York, and a speaker at this morning's session, Carman G. Blough; member of the council of the American Institute of Certified Public Accountants, New York, partner, Keller, Kirschner, Martin and Clinger, Columbus, Ohio, James N. Buccalo; Past President of the Public Accountants Society of Ohio, partner of Traeger, Rose and Associates of Cleveland, Morris Traeger; Vice President of The Ohio Society of CPAs, partner of Haskins and Sells of Cincinnati, Harry R. Weyrich; comptroller of Bristol Laboratories, Syracuse, New York, and a speaker at this afternoon's session, Hans C. Todt; Treasurer of The Ohio Society of CPAs, partner of Stirgwolt, Baldwin and Loofbourrow, Columbus, Clark E. Loofbourrow; President of the Federal Government Accountants Association, Deputy Chief, U. S. Army Audit Agency, Washington, D. C., and a speaker at this afternoon's session, Laurence W. Acker.

During 1954-55 (at the time Mr. Stans was President) the next man was Vice President of the American Institute of Certified Public Accountants and partner, Keller, Kirschner, Martin and Clinger, Columbus—John C. Martin; Director of the Bureau of the Budget of the Federal Government, the principal speaker at this evening's banquet, and in a very real sense, the guest of honor of the Institute, Maurice H. Stans; last but not least, the Chairman of the Accounting Department of the Ohio State University, Paul E. Fertig.

Now, let us have a hand, please. (Applause)

The second, and a very happy function of this luncheon for me has been announced in your program. For years, the Ohio Society of CPAs has given recognition to the top two successful candidates in the previous CPA examinations. The May 1960 award winners are oblivious to this forthcoming honor, as they are this minute getting set to solve the second batch of CPA problems. These candidates will receive their awards at the annual convention to be held in Cincinnati in October.

Today we have the November 1959 award winners with us. To present these gentlemen to us, it is my pleasure to introduce a fellow Toledo Chapter CPA William Schmeltz, Chairman of the Ohio Society Committee on Education.

Before he stands, I should like to make a correction which is too new to appear on the program. Bill is the dean-elect of the College of Commerce at Bowling Green State University in Bowling Green, Ohio. Bill Schmeltz. (Applause)

MR. WILLIAM SCHMELTZ: Thank you, Bob. With an introduction like that, I ought to make a regular speech—a good half hour, I suppose. However, he said "Are you all set to go, or should we let them have another 15 minutes to enjoy themselves before you start?"

President Draper, ladies and gentlemen: On this very day, May 19, 50 years ago, Bowling Green State University was formed by an act of the Legislature. My first official duty is to administer the first formal function we have, and that is to honor Governor DiSalle with an honorary degree today.

During this past year we have opened the archives of the University, and find that in 1910 our major problem on the campus was tobacco. No mention of alcohol. Also, we had cows grazing on the malls, and courses in dairying. The important point is that we have had a lot of development in the last 50 years.

I remember that last year when we were in Columbus, the Ohio Society of Certified Accountants also celebrated their 50th anniversary. They opened their archives and awarded plaques and many other things. It was a great day for the Society when they recognized the development that has taken place—the recognition of accountancy as a profession over all these years. Of course, I am a professional educator and I like to believe that education has played an important part in the development of accountancy as a profession.

Along these lines we of the Ohio Society of CPAs take pride in being able to honor the highest scholastic achievement to the recipient of the highest scores of the fall 1959 CPA examination. It gives me pleasure to present to you the two award winners of this current year.

I want to present our second place award winner first. He is a graduate of Kent State where they also celebrate their 50th anniversary this year. He is working toward an M.A. degree at Western Reserve, is 28 years old, married, one child. He is a member of the firm of Price, Waterhouse in Cleveland; a member of the National Association of CPAs; has also become a member of the Ohio Society; and a member of Delta Sigma Pi. I present to you Curtis G. McCort for second place award winner. It gives me great pleasure. (Applause)

CHAIRMAN DRAPER: Mr. McCort, I should like to read to you what this certificate says. "The Ohio Society of Certified Public Accountants presents this award to Curtis Glenn McCort for second highest proficiency in the Ohio Certified Public Accountants examination of November 1959."

It is a great pleasure to do this. I have one other presentation to make, and that is a membership in the Ohio Society of the Certified Public Accountants for one year. Congratulations.

MR. CURTIS G. MCCORT: Thank you very much, Mr. Draper. It certainly is an honor to be here today. I should like to express my appreciation to the Ohio Society for the award, and also for inviting me here to this Institute. I think we need to do things along this order. We need to stop and assess our responsibilities occasionally. We need to, you might say, get our heads out of the sand and away from the ledgers and textbooks, and see how we stand, as far as meeting our responsibilities as accountants. So I would like to thank, again, the Ohio Society for making this possible, and extend my congratulations to the person on my right, who has placed first in the past examination. Thank you. (Applause)

MR. SCHMELTZ: Thank you. Would the first place award winner please stand? He attended Western Reserve University, is also a native Ohioan, age 27, and he told me he was married last September, when he should have been studying for his fall examination. He is a member of the Walthall-Drake firm in Cleveland, a Beta Alpha Psi member, and a member of the Ohio Society of Certified Public Accountants. It gives me a great deal of pleasure to present Eugene L. Diamond, first place award winner. (Applause)

CHAIRMAN DRAPER: Mr. Diamond, let me read what this certificate says: "The Ohio Society of Certified Public Accountants presents this award to Eugene L. Diamond for the highest proficiency in the Ohio Certified Public Accountants examination of November 1959."

On behalf of the Ohio Society, it gives me great pleasure to present this award, and also a year's membership in the Ohio Society. Congratulations. (Applause)

MR. EUGENE L. DIAMOND: Mr. Draper, Mr. Schmeltz, ladies and gentlemen: It is with humility, but with pleasure and appreciation, certainly with pride, that I accept this award. I trust that I can make a worthwhile contribution to the fine profession of accounting. Thank you. (Applause)

CHAIRMAN DRAPER: Thank you very much, Bill, and to you two gentlemen, again congratulations. I am sure they will make very welcome additions to our Society and our profession.

Now, two-thirds of the functions that I had to perform at this luncheon are completed. The remaining job is to adjourn the meeting, but before I leave I cannot resist taking the opportunity to suggest that there are two states of mind in which we can approach the problems of our profession. One approach is what I would call the upside-down approach. If you have this state of mind, you are quite sure that we accountants have all the answers, and the only difficulty is to find the right system.

From this angle, the Institute is like Steve Allen's question man. If it keeps on bringing together enough men who already have the answers, they will have to start bringing in the kind of speakers who will ask the convenient questions. From this upside-down point of view, you can see it will be just a matter of time before the Institute would be out of business along with the whole profession.

Looking at it right-side up, I believe we should approach the Institute in the state of mind that it is a major marketing center for professional intelligence kits, that will sooner or later, one at a time, provide the answers. In this crazy mixed-up world, people need all the intelligence kits they can find.

Each of you has any number of do-it-yourself kits, like a TV repair kit, a kit on how not to slice your putts, etc. The kit that I am talking about, the intelligence kit, is an advanced development of the do-it-yourself variety. It is specially geared to operate at top efficiency only when we connect it with other similar kits. There are quite a few varieties available.

Allen Goss has a central intelligence kit, by the way, which is currently being reanalyzed with regard to the "you, too" spy section. Then there are the military intelligence kits, the banking and credit intelligence kits, the business management intelligence kits, etc. Each type of intelligence kit eventually provides the answers when enough of their owners get them connected properly.

As accountants we need the best professional intelligence kits that we can develop, because, brother, we have problems. In college we got a good basic kit, and we have been adding to it on the job and by reading professional journals.

Unless you have the genius kit, you must continually shop for good ideas, and that is what we are here for, and that is why I know that the Institute is a major marketing center for intelligence kit packages.

I would say, too, that with its customary efficiency, the College of Commerce at The Ohio State University has even provided a mail order department. The proceedings of this Institute will be published, and I think you should tell some of the people who are not here that they can get these papers in published form.

This morning we offered you some mighty fine packages for your personal development kits.

At 2:00 P. M. in the West Ballroom there will be even more idea men displaying their samples. Some of our fellow accountants who are not here may perhaps have an upside-down approach. But the fact that you are here is evidence to me that you are right-side up, and are looking for top answers, not convenient questions.

This luncheon meeting is adjourned.

THIRD SESSION

THURSDAY, MAY 19, 2:00 P. M.
The Ohio Union—West Ballroom

Presiding:

LESLIE I. ASHER, *President, National Association of Accountants; Manager of Finance, Small Aircraft Engine Department, General Electric Company, West Lynn, Massachusetts*

Paper: "Controllership Education"

HANS C. TODT, *Comptroller, Bristol Laboratories, Syracuse, New York*

Paper: "Distinguishing Good from Not-So-Good Accounting Research"

ROBERT N. ANTHONY, *Professor of Business Administration, Harvard University, Boston Massachusetts*

Paper: "Improvements in Control of Defense Resources"

LAURENCE W. ACKER, *President, Federal Accountants Association; Deputy Chief, U. S. Army Audit Agency, Washington, D. C.*

THIRD SESSION

PROF. ELZY MCCOLLOUGH: I should like to welcome you to this afternoon session. Mr. Leslie Asher will preside. He was reared in Iowa, therefore, I feel a kindredship to him. He is a graduate of Iowa University, and has been with General Electric for more than 25 years. He is presently Manager of Finance for the Small Aircraft Engine Department of that company.

He has been active over the years with the National Association of Accountants, and is serving as President of the Fort Wayne Chapter, national director and many other capacities with the Association. He is presently President of the National Association of Accountants. I give you Mr. Leslie I. Asher.

CHAIRMAN LESLIE I. ASHER: Thank you very much. It is a real pleasure for me to be here. I think I ought to explain a little about what the Small Aircraft Engine is because it is often misinterpreted, as being of no consequence. Small means engines up to and including 7,500 horsepower. Those are the sizes that we make in Lynn, Massachusetts. The larger sizes are made at our Evendale plant near Cincinnati. I wanted to make sure that you know that *small* is pretty good-sized after all.

This is my first visit to the Accounting Institute. I have heard it favorably mentioned for many years, and therefore when the opportunity came to me to be present at one, I accepted. I am very happy to be here, and I think one of the reasons is that I have seen a good many of my friends from NAA and elsewhere, and perhaps even more than that, to share this platform with the distinguished speakers that we have this afternoon, as well as the distinguished speakers which you heard this morning.

I do want to bring to you the greetings of the National Association of Accountants. One of my good friends in the audience this morning, knowing that I am quite enthusiastic about NAA said, "Leslie, I suppose you are carrying some application blanks around for membership." "No," I said, "I forgot to bring them, but I will invite anyone who is not a member, and who is interested in becoming a member, to join up with NAA." That is my plug for today.

I think we have a wonderful, fine program lined up this afternoon. We are somewhat gifted at this Institute. On this program there is the top brass in the accounting profession today and tomorrow. So it is a real pleasure to participate in a program of this character, and I think the committee who planned the Institute, and this program, are certainly to be complimented on bringing all this real high caliber top brass of accounting to this platform.

Now, this afternoon we are going to go in a little different direction. We have three wonderful speakers to carry us along on this side of the street. There is no gambling in this particular deal, because these are all top-notch speakers.

Our first speaker is Hans C. Todt. He is Comptroller of Bristol Laboratories, Syracuse, New York. He is a CPA of the State of New York; a graduate of New York University, and he also has a Master of Administration from Syracuse University.

He is chairman of the National Committee on Education of the Comptrollers Institute of America and a Vice President of the American Accounting Association. He is also a member of the Advisory Board of the Institute of Accounting of Columbia University. He holds memberships in the American Institute of CPAs, the New York State Society of CPAs, and the National Association of Accountants.

What more can you want than a controller to talk on the subject of "Controllership Education." Therefore it is a real pleasure for me to introduce you to this audience for this subject. Hans Todt.

CONTROLLERSHIP EDUCATION

HANS C. TODT
Comptroller, Bristol Laboratories
Syracuse, New York

The Development of Controllership

The tremendous expansion of American business during the past 50 years and the demand on the part of business managers for more adequate and scientific accounting and more exact financial control were some of the factors in the development of "Controllership." While there are many reasons that have brought about the emergence of this phase of business activity, some of the more important ones are: the growth in size and complexity of organizational units; the vastly increased intervention in business for taxation purposes and for regulation of many activities in the public interest; the financing of business enterprises and the growth in use of the planning and controlling technique.

As a result, business has found it necessary to centralize in a specialized administrative officer the responsibility of dealing with many problems caused by the foregoing internal and external forces.

Among many recognitions of this new development are the formation of the Controllers Institute of America, the offering of courses in controllership by many universities, and the establishment of Army and Navy controllership programs at collegiate institutions. The Army and Navy controllership courses are of particular significance because they are the basis of developing controllership functions in government.

Thus, while the progress of controllership has been particularly marked during the past 25 years, its growth since World War II, and especially since 1950, has been even greater. It can be said that controllership has matured; it has become of age; it has attained an important place in American business.

The Controllership Function: A Modern Concept

The increasing complexities of business administration have brought about a corresponding development of the controllership function. Modern controllership is primarily a service function, a part of top management, involved in the over-all planning, coordinating and controlling functions of industry.

In many small companies, the controller is the chief accounting officer and his responsibility is to supervise the work in cost accounting, budgets, general accounting, systems and procedures, and related areas. In larger companies, much of the foregoing is performed by the controller's associates with the controller retaining the ultimate responsibility.

The Controllers Institute's concept of the function of controllership is:

1. To establish, coordinate and administer, as an integral part of management, an adequate plan for the control of operations. Such a plan would provide, to the extent required in the business, profit planning, programs for capital investing and for financing, sales forecast, expense budgets and cost standards, together with the necessary procedures to effectuate the plan.

2. To compare performance with operating plans and standards, and to report and interpret the results of operations to all levels of management and to the owners of the business. This function includes the formulation and administration of accounting policy and the compilation of statistical records and special reports as required.

3. To consult with all segments of management responsible for policy or action concerning any phase of the operation of the business as it relates to the attainment of objectives and the effectiveness of policies, organization structure and procedures.

4. To administer tax policies and procedures.

5. To supervise or coordinate the preparation of reports to governmental agencies.

6. To assure fiscal protection for the assets of the business through adequate internal control and proper insurance coverage.

7. To appraise economic and social forces, and government influences continuously and interpret their effect upon the business.

Controllership Today

From the foregoing description of the duties of the controller, it is apparent that controllership in many companies is in a sense a custom-built function developed and adapted to the individual company. However, one must recognize that the controller is not one man but a group of men. Actually, the controller must be thought of as a function rather than an individual. Thus, the controller must think first in terms of the basic functions of top management; in other words, the development of a management viewpoint is of utmost importance. Since controllership makes a vital contribution to the planning and control of a business enterprise, the controller must direct his own efforts towards contributing to the accomplishment of these same objectives. The controller, by the very nature of his work, is in a unique position of becoming familiar with the most detailed internal factors as well as the over-all operating picture of a company. Consider, for instance, some of the specific tasks which are performed under the supervision of the controller. Traditionally, he has been a reporter for, under his direction, expenses, and so far as they can be expressed in financial terms, the accomplishments of all departments are recorded.

It is clear that recording the foregoing involves accounting procedures. However, it should be emphasized that accounting is not the first concern of controllership but that it is one of the many parts of the controllership function. Within an industrial or commercial organization, a controller is a control officer. He employs accounting techniques for the purpose of accomplishing the control function. *The realization of this basis truth is the first step in discerning the contrast between controllership and accounting.*

The controller who aspires to attain real controllership status must delegate the accounting tasks and devote his time to make plans and devise procedure to further the basic objectives of top management. Under the pressure of present business activity, the controller's responsibility has been greatly increased and broadened. Management looks to him for all types of historical information, properly analyzed and interpreted. In addition, management depends upon him to supply data with considerable emphasis upon the function of forecasting and planning. In other words, while management is interested in what has transpired, its main interest is what lies ahead.

The controller's interest should primarily concern itself with the active planning, coordinating and control of the corporate enterprise. To fulfill these responsibilities requires that he be a man with a broad background possessing imagination and the ability to achieve objectives with the cooperation of other people.

Controllership Future

Even though great strides have been made in developing the field of controllership, it is probable that controllership has not by any means reached its peak. Controllership, geared to embrace every phase of the company's operations with its planning and control principles, is full of opportunity and inspiration.

There are, indeed, many areas in which controllers must accept the challenge of keeping up-to-date. One of these, the field of Electronic Data Processing, is of particular importance because by means of high speed computers, analytical processes which in the past have been well beyond the reach of a controller's function are daily being made feasible. The controller in an endeavor to keep abreast of this ever-changing field, should limit his study to methods of determining the applicability and limitations of high speed computers and should devote very little time, if any, to techniques, such as programming, etc.

Then, there is the field of Operations Research which, through the use of statistics and more recently with the assistance of Electronic Data Processing, has made great strides in helping management study and solve its many administrative and technical problems.

One of the newer phases of the controller is that relating to industrial relations. Because the controller is relied upon to furnish much needed financial information in labor negotiations he has become an important member of the management bargaining team. Likewise, he is interested in good labor relations because these generally lead to lower manufacturing labor costs.

Long-range planning is another important function of business management for which there is an absolute need. Sometimes, because of the day-to-day operating problems, this function is often overlooked. However, most businesses make an attempt to look ahead from 3 to 10 years in making plans. The controller, through the medium of forecasted statements of income and expense and financial condition, can encourage this approach.

In discussing the future modern concept of the controller's function, it is appropriate and important to emphasize the fact that functions of planning and performance evaluation are not the controller's alone. In effect, every key executive, in discharging his responsibilities, is or should be his own "Controller." If controllers will recognize that real control is achieved only through actions taken by executives other than themselves, they will be more cognizant of the service aspect of their position which is primarily to assist key executives in the proper performance of their functions. The foregoing concept presents a constant challenge to controllers to improve services which they render to other key executives. More emphasis upon this difficult role will increase the value of the controller as a member of the top management team. In this connection it is appropriate to emphasize that the controller cannot be a "rear view mirror" driver. He must present a forward-looking approach.

Broad Preparation and/or Specialization

The preceding has dealt with the development of controllership, its growth in importance to American business and the basic duties and responsibilities of the controller. With this background, it is possible to consider the kind of education that will fit men for controllership. Should controllership education consist essentially of broad preparation or specialization? Or should the educational program for controllership encompass a balance of broad education supplemented by specialization in accounting, finance and related subjects? It would appear that many functions performed by the controller suggest the need for a broad education supplemented by specialization in the aforementioned areas and that the issue is primarily one of emphasis.

Educator's Viewpoint

In discussing controllership education, educators have stressed the point that the first two years of college education should provide broad general education courses in such subjects as mathematics, philosophy, psychology, economics and modern science. Such broad general education will give the student an understanding of the world in which we live, will enable him to associate on equal terms with others of similar educational background and should develop the faculty of clear thinking. These two years of broad general education should be supplemented by two years of intensive study in the field of business. Thus, preparation of the student for his first job should be subordinate to the development of transferrable business talents for, as yet, unknown tasks of tomorrow.

It is apparent that controllership education should mean broad preparation followed by specialization, to enable an individual not only to absorb and utilize the technical aspects of his own subject, but in addition, to enable him to understand its relation to other phases of the corporation. In addition, an individual's education should make him a useful citizen through a broad background of knowledge of the cultural, economic and social developments which are a part of our present civilization. It is also important that education provide the means whereby the individual will realize the greatest enjoyment of living usually through curricula which deal broadly with the things of life about him. By the same token, it should be noted that any program which emphasizes only the latter phases and does not prepare a student for making a living has failed to realize a major purpose of education.

Industry's Viewpoint

Industry's viewpoint concerning the matter of broad education is expressed by Clarence Randall, President of Inland Steel.

> "The weakness of technical education as a preparation for a business career — when it is not balanced by participation in liberal disciplines, is that it leaves in the mind of the student the impression that all problems are quantitative and that a solution will appear as soon as all the facts have been collected and the correct mathematical formula evolved. Would that life were that simple! Unhappily, the mysteries of human behavior from which come our most complex problems do not lend themselves to quantitative analysis, and there is no mental slide-rule which can serve as a substitute for straight thinking."

Upon the occasion of his retirement, Mr. Randall remarked that the greatest asset he had in business from the personal view of preparation was the general education he received at the undergraduate level. Randall went on to say that early selection of a specialty would have been a limiting factor, although he admitted that it might have brought him more money in his earlier years.

In addressing a meeting of the Cleveland Control of the Controllers Institute of America on the subject "Education for Controllership," Mr. A. G. Patterson, President of the Square D Company, suggested that a student "take the toughest liberal arts undergraduate course he can handle" on the premise that the controller as a top executive, will need a broad perspective as well as a disciplined mind.

Summary

In summary, it is apparent that the extension of the controllership function has created new problems for the student who would prepare himself to take part in this important phase of business management. It is no longer sufficient that he attain a reasonable mastery in the field of accounting, for he may, when he moves into the management scene, find himself employing a variety of analytical methods — all in addition to the more or less central function, the delegating of processing accounting information. And if these analytical processes are to provide useful information for operating management, the controller must be able to communicate the results effectively. Thus, he must have sufficient knowledge of the production, marketing and financial functions to permit him to work intelligently with individuals directly concerned with these areas. He must also have an understanding of the more general management functions of organization and planning. The formal training offered the student interested in preparing for this area should be adapted to this basic change in the nature of the controllership function.

In view of the foregoing comments, it appears that the Collegiate Schools of Business which attempt to give general education, general business education and specialized training in one area of business make an immediate contribution to controllership through the training of potential future controllers. It should not be implied, however, that Collegiate Schools of Business can turn out finished controllers.

Finally, it can be said that men succeed in a profession because they have learned to analyze correctly difficult situations and to think problems through to a logical conclusion. Thus, professional education must not be confined to technical skills, but must be comprehensive enough to train the student in independent thinking and to develop capacity for leadership.

Need for Survey

Controllers have often expressed an interest as to the education, in terms of course content, scope, etc., which is actually being offered in training students to prepare themselves for a career in the controllership field. This lack of information and the collective interest on the part of controllers regarding controllership education were some of the reasons for undertaking a controllership education survey. The need for more information concerning controllership education, for example, was also reflected by the National Committee on Education in its annual report to the Board of Directors of the Controllers Institute.

> We believe that adequate education for controllership can be achieved only through more fully developed and better oriented curriculum, including all phases of corporate accounting and control. A specific course devoted to the functions of the controller, his method of operating and management, and the types of problems with which he deals, can properly be part of such curriculum. Also, we believe it should be considered as a possible orientation course for other business school students not majoring in accounting.

Thus, after reviewing the matter carefully, I was convinced there existed a need for more information concerning the prerequisites, content and scope of controllership courses taught at all collegiate levels, and since there was definite lack of pooled information concerning controllership courses being taught currently in institutions of higher learning, recommended that a questionnaire be prepared. Subsequently, the support of the Committee on Education was enlisted and a questionnaire was mailed to undergraduate and graduate schools of business.

Preparation and Approval of Questionnaire

In the preparation of the questionnaire, it became apparent that in order to obtain the maximum benefit, the scope of the questionnaire should be sufficiently broad to include not only information relating to present controllership courses being offered at the collegiate level, but also to obtain from educators their thinking on future controllership education. Thus, the questionnaire was divided into three sections as follows:

Section I — The Controllership Course per se

This section requests information concerning controllership courses being offered.

Section II — Controllership Program

This section seeks information concerning a comprehensive program in controllership.

Section III — Future Development of Controllership Course

This section goes beyond the actual present-day controllership course concept and invites the opinions of educators concerning not only the teaching but also the content and objectives of a controllership course.

The approval of any questionnaire by an authoritative source is always of considerable assistance in securing a representative number of replies. It was, therefore, gratifying to have the Standards Committee of the American Association of Collegiate Schools of Business place its stamp of approval upon this questionnaire.

Purpose of Survey

The primary purposes of the controllership education survey can be summarized as follows:

a) To ascertain the content of the controllership courses and controllership programs being offered in Collegiate schools of business.

b) To enable schools of business to evaluate their controllership education program.

c) To furnish schools of business with topics which educators feel should have future emphasis in the teaching of controllership education.

d) To make educators aware of deficiencies in present controllership course or program and indicate in what areas improvements can be initiated.

e) To lay the foundation for improving the understanding between controllers and educators in the field of controllership education.

It must be admitted that while the foregoing purposes are ambitious, the survey, nevertheless, provides for the first time a comprehensive summary of controllership education at the collegiate level.

SECTION I — CONTROLLERSHIP COURSE PER SE

Introduction

As a controller engaged in the application of controllership principles and problems of management, as an instructor of a controllership course at the graduate level and finally as chairman of the National Committee on Education of the Controllers Institute of America, I have often expressed a curiosity concerning controllership education which is offered at the collegiate level.

This curiosity expressed itself in the following questions about controllership education. How many schools of business offer a course in controllership? What department offers this course? What are the prerequisites to enroll? What topics are included and how much time is allotted to each topic? Are the principles of management planning and control really stressed? What other teaching aids in the form of plant visitations (and others) are employed? What, if any, deficiencies are being encountered in the teaching of the course? The answers to the foregoing questions could, naturally, best be answered by educators in schools of business.

Thus, in May 1958, questionnaires were mailed to deans, department heads, and faculty members of 185 collegiate institutions offering organized curricula in business, as shown in the Delta Sigma Pi Fifteenth Biennial Survey of Universities offering an Organized Curriculum in Commerce and Business Administration.

The summarization of replies received in answer to Section I of the questionnaire follows:

Do you offer a course in Controllership per se?

No — 73
Yes — 61
Other — 21 (Comprehensive program, but no specific course in Controllership)
Total 155 (84% return)

Of the schools that answered "Yes," Controllership courses were offered at various levels, as follows:

At Graduate Level Only	28
Undergraduate Level Only	18
Both Graduate & Undergraduate Levels	12
Adult Education Level Only	2*
Both Adult Education & Graduate Levels	1*
Total	61

The summary indicates that more than 50 per cent of the respondents offer either a controllership course per se, or a comprehensive controllership program, and that 30 per cent of respondents offering a controllership course offer it only at the graduate level. These figures are revealing because it has only been in the last decade or so that controllership has attained its importance in business organization. Nevertheless, schools of business have recognized this trend and have provided academic instructions in this field.

The fact that 73 schools out of a total of 155 respondents do not offer any controllership course or program, raises the question why these institutions have not included controllership education in their curriculum. In the absence of more detailed replies, the assumption may be made that reasons of a purely local nature have prevented these schools from offering at least a comprehensive program in controllership education.

Name of Course listed in catalogue

Fifty-three of 61 replies incorporated the word "Controllership" in the course title.

Department offering course

Out of a total of 61 replies, only 11 indicated that the course is offered by a department other than the accounting department.

Academic credit hours

Thirty-two of the respondents grant three credit hours, with about 18 of the replies indicating two credit hours.

Number of hours per class meeting and total hours per course

At the undergraduate level, 9 replies of a total of 18 replies indicated one-hour sessions, whereas at the graduate level, 16 of a total of 31 replies indicated the two-hour session. Insofar as total hours for the course is concerned, 15 replies indicated 30 to 34 hours and 16 replies 45 to 49 hours per course.

Prerequisite

Approximately 40 per cent, or 26 replies indicated that a full undergraduate accounting program, or three undergraduate accounting courses are required for enrolling in the controllership course.

Others mentioned were:

Intermediate Accounting and Cost Accounting (8 replies)
Principles of Accounting and Cost Accounting (6 replies)

Various Combinations of Accounting Courses (9 replies)

The replies indicate that accounting courses are generally required before admitting a student to the Controllership Course. This would agree with some expressed sentiment that while Controllership is a management function, one of the tools of Controllership is a knowledge of accounting.

Name of text books used

Controllership by Heckert & Willson, and *Practical Controllership* by Anderson, are the two books which are used by the majority of respondents.

One of the revealing aspects of the replies received to this question, is that a number of institutions use The Controller and Controllership Foundation books as a part of the course of instruction.

Topics included in controllership course, etc.

By far, one of the most important questions is the one which relates to topics included in the controllership course. Summary of replies places the emphasis listed in order of importance, as follows:

Controller's Functions and Organization
Principles of Management Planning
Budgets-Operating
Reports to Management
Internal Audit
Budgets-Cash and Capital

Although the foregoing topics were accorded prime emphasis, this does not mean that these are the only topics of a controllership course. Others included are: Accounting General, Financial Analysis, Human Relations, Cost Accounting, and Accounting for Distribution Costs.

Do you arrange plant visitations?

Forty-six of the respondents do not employ plant visitations as part of the controllership course.

Do you utilize outside speakers?

Out of 61 replies received, 38 replied in the affirmative. Members of the Controller Institute have been utilized by about 50 per cent of the respondents.

Do you assign term projects?

About 60 per cent of the respondents replied in the affirmative.

Do you use other materials?

About 60 per cent of the respondents employ materials in the form of required reading supplementing the coverage of the text book material.

Major deficiences of course:

Inadequate text books and the lack of case material are two major deficiencies mentioned by virtually all respondents. Other deficiencies mentioned, however, with less emphasis, are lack of student perception of management use of accounting, inadequate material and facilities not available.

SECTION II — CONTROLLERSHIP PROGRAM

Introduction

It will be recalled that Section I concerned itself primarily with matters relating to a controllership course. However it was realized that there are some schools of business which, while they do not offer a controllership course, do, however, offer a comprehensive program in controllership. It would, therefore, be of interest to know what the components of such a program are and to what extent they appear in the several programs. This information received from 21 respondents has been summarized and appears below:

Courses	*Included by Respondents*	*Courses*	*Included by Respondents*
Principles of Accounting	19	Statement Analysis	5
Cost Accounting	19	Liberal Arts Courses	5
Budgetary Control	15	Written Communication & Report Writing	5
Finance	15	Machine Data Processing	4
Income Tax Accounting	14	Forecasting	3
Advanced Accounting	13	Personnel Administration	3
Auditing	12	Advanced Problems	3
Intermediate Accounting	11	Intermediate Theory	2
Statistics	11	Industrial Engineering	2
Economics	9	Business Mathematics	2
Business Organization/Ind. Mgt.	9	Government & Business	1
Managerial Accounting	8	Transportation	1
Business Law	7	Industrial Psychology	1
Systems & Procedures	7		
Marketing	6		

It is quite apparent that each of the items stressed by the respondents are normally included in the typical accounting program of the Collegiate Schools of Business. For example, the typical curriculum for accounting majors as prepared by the Task Committee on Standards of Accounting Instruction contains the following accounting courses:

Elementary	Auditing
Intermediate	Income Tax
Advanced	Additional Cost or
Cost	Auditing

A comparison of the courses listed in answer to the questionnaire with the foregoing curriculum, leads one to the conclusion that there is no reason why the subjects listed in answer to this question cannot be fitted into the typical accounting program offered by a Collegiate School of Business. It should be mentioned, however, that emphasis should be upon private accounting and less upon public accounting. It might also be more logical to substitute a course in controllership for the additional course in cost and the additional course in auditing.

SECTION III — CONTROLLERSHIP EDUCATION— FUTURE EMPHASIS

Introduction

Sections I and II of the questionnaire deal with replies from institutions, and summaries of responses contain only one reply from each participating school.

I was also curious and believed it important to know the educators' thinking about the future of controllership education. If, for instance, educators felt that there were deficiencies in the present teaching of controllership, how could these be remedied? At what level should students be permitted to enroll in future controllership courses? What are the objectives of a controllership course? These were questions included in Section III in order to elicit individual opinions of educators.

SECTION III — EDUCATORS' OPINIONS

This section invites the individual *opinions* of educators regardless of whether a controllership course or a comprehensive controllership program is offered. Thus, it provides a summary of educators' views concerning controllership education.

Do your believe the concept of controllership can be taught in a five-year program?

Respondents answering in the affirmative numbered 144, 6 respondents replied in the negative and 17 respondents gave no answer.

If yes, how would you allocate hours (use 150-hour base)?

The greater number of the respondents indicated that the hours be allocated as follows:

Liberal Arts	51–60
Accounting	21–30
Finance	10 or less
Economics	11–20
Related Business Subjects	21–30

What department should have the responsibility of developing this program?

Although there appears to be some diversity of opinion as to the department which should have the responsibility of developing the controllership program, 98 respondents, or about 70 per cent, expressed a preference for the accounting department to assume this responsibility, and 27 respondents preferred accounting and management departments jointly.

What minimum prerequisite in accounting do you believe should be established for a controllership course?

A minimum requirement (in terms of hours, 22) was indicated by 64 respondents. Two years of accounting plus cost accounting was mentioned by 44 respondents while 14 respondents listed advanced accounting.

Should such a course be offered only to accounting students?

More than 50 per cent of the respondents replied in the negative, thus indicating that the opportunity to enroll in a controllership course should be offered to non-accounting students as well.

Under what circumstances, if any, do you believe Liberal Arts Students should be permitted to take the course?

As a general statement, most educators (90 per cent) state that a student should be permitted to enroll provided he possesses the proper prerequisites, the experience equivalent, or an expressed interest.

Should a controllership course be taught only at the graduate level?

The replies indicated that 55 per cent believe that such a course should not be taught only at the graduate level. Answers to the question which requested an explanation why the respondents believed that the course can be taught at the undergraduate level mainly expressed confidence that a mature, senior student should be able to absorb training in controllership.

How would you strengthen instruction in the controllership area?

Listed in the following order of importance to strengthen present controllership education were: better cases, problems and text, increased emphasis on management in existing courses; better instructors, and internship; business men; controllers as lecturers and part-time instructors.

What topics should be included in the controllership course?

Although 14 topics received some degree of emphasis by the respondents, the following topics listed in order of importance received the major emphasis:

Principles of Management Planning
Budgets-Operating
Budgets-Cash and Capital
Financial Analysis
Controllers Functions and Organization
Reports to Management
Internal Auditing

Indicate the objectives of a controllership course

Ranked in the order of importance were the following objectives:
Develop knowledge of Business Planning and Organization
Develop a "Management Viewpoint"
Teach Application of Budgets and Control Procedure

What areas in controllership education should have increased future emphasis?

Develop the management viewpoint, was mentioned by 46 respondents, with 21 respondents listing Human Relations and 20 respondents indicating Electronic Data Processing. Other areas mentioned were Report and Data Presentation, Budgets and Planning and Forecasting in that order.

How can the Controllers Institute assist colleges in controllership education?

The areas of assistance mentioned most frequently by respondents and listed in order of importance are: Providing Case Material, Summer Work and cooperative part-time Training Program, and Controllers as Visiting Lecturers and Plant Visits.

Summary

A careful review of Section III of the Controllership Education Survey will quite readily indicate the several areas which controllers feel should receive future emphasis.

It is apparent that the training of students who want a career in industrial accounting should include more stress on management, economics, budgeting, communications, human relations, and controllership than is required for accounting majors. If this were done, such a curriculum would be fully in accord with the objectives of controllership education.

In discussing the future of controllership education, there must be a realistic approach to the question whether four years of college training provides sufficient time to accomplish the three functions of accounting education; namely, educating the citizen, education in business and education in accounting.

Proponents of the five-year plan feel that in order to provide the necessary cultural background supplemented by business training and specialized training, four years are inadequate. This question has been studied by the Committee on the Scope of the Four Year Accounting Major, appointed by the American Accounting Association. The committee concluded that the broadening of the scope and content of the four-year undergraduate major will occur by (1) reduction in total undergraduate hours in accounting, (2) an increase in the number of hours in business subjects, and (3) an increase in required liberal arts courses. The report also expressed the belief that while there will be a trend toward five-year accounting programs, such programs will not eliminate the need for a four-year undergraduate accounting major.

Whether the education program is accomplished within four years or five is a decision which must be made by each school. The important point to be remembered in arriving at such a decision, however, is to be certain that the training prepares the student to discharge effectively his responsibilities as a citizen, as a businessman and as an accountant.

Conclusion

The growth in importance of the controller's role in our business life was indicated earlier. That this role has not by any means reached its peak was likewise discussed. It is safe to predict, therefore, that emphasis upon proper training in the controllership area by schools of business will have to increase in order that education may keep pace with the requirements of industry. While this aspect constitutes an immediate challenge, it is encouraging to note the survey reveals that 53 per cent of the respondents provide a controllership course or a comprehensive controllership program.

Objectives and Content of Controllership Course per se

It is only natural before any suggestions are made concerning content of a controllership course per se, that the objectives of such a course be established.

According to the information already presented in the preceding Summary, most educators mentioned that the following objectives be incorporated in a controllership course: developing the "management viewpoint;" developing knowledge of business planning and organization; teaching applications of budgets and control procedures. Therefore, the subjects which should be included are those which make a direct contribution towards accomplishing these objectives.

A controllership course should, in effect, pull together all of the previously acquired accounting education of the student and apply it to the problems of controllership. It is, therefore, not a course in accounting in a sense of techniques and procedures. The course should teach the student how accounting can be used to serve business in the solving of its administrative problems. The course should develop how the controller's division is organized, how the controller functions, and stress the controller's service relationship with other departments. Throughout it is essential that the student be encouraged to put himself in the position of a controller in order to derive the greatest benefit from the course.

The question then arises as to what topics should be included in the course content in an endeavor to achieve the foregoing objectives. From Section III of the Summary, the following topics were suggested by educators:

Principles of Management Planning; Budgets — Operating Budgets — Cash and Capital; Financial Analysis; Controller's Functions and Organization; Reports to Management; Internal Auditing.

In addition to the foregoing, educators mentioned the following topics as deserving future emphasis in the teaching of controllership:

Developing the Management Viewpoint

Human Relations and Electronic Data Processing

Other topics which the speaker would suggest for inclusion are:

Operations Research

Accounting Control of Operations, and

Accounting Policy and Accounting Systems

The foregoing topics, it would appear, should provide the student with a sound and comprehensive course in controllership.

While it may be desirable to include all of the foregoing topics in a controllership course, the relative importance of each of the topics to the objectives of the course and the amount of time available become, of necessity, determining factors in the final choice of topics selected. In order to cover these topics adequately in class, it is suggested that from 36 to 42 classroom hours be made available and that three semester credits be given.

To attain the objectives of controllership course, the necessary tools are essential. It is, therefore, disturbing to note that the major deficiencies in teaching the course are inadequate text books and lack of case material. In addition to these deficiencies, educators also indicated that instruction in the controllership area could be strengthened by an increased emphasis on management in existing courses, and better instructors and internship.

Recognition on the part of educators of the foregoing is perhaps the first step in alleviating these deficiencies. To remedy the lack of case material, members of the Controllers Institute are in the process of preparing cases which could be utilized in the teaching process.

Objectives and Content of Controllership Program

The objectives which have been indicated for a controllership course per se are equally applicable to a controllership program.

In suggesting the topics to be included in a controllership program as distinguished from those included in a controllership course per se, the first question which arises and which it appears requires major consideration, is the distribution of the total credit hours to the component parts of the curriculum leading to a degree.

As previously mentioned, in my opinion, two years should be devoted to the liberal arts courses in such a program. The remaining credit hours could then be divided among courses in business administration and accounting. Since a controllership program transcends both of the foregoing, no attempt has been made to allocate specific topics to either business administration or accounting, the major purpose being to submit course content for a controllership program.

It is my belief that the following controllership program is entirely compatible with the typical accounting program except that the *emphasis should be upon private instead of public accounting.*

The following topics are submitted for inclusion in a total controllership education program:

Accounting-Principles	Budgetary Control
Accounting-Cost	Economics (Trends & Cycles)
Accounting-Distribution Costs	Advanced Business Mathematics
Accounting Systems & Procedures	Finance-Money-Banking- Trends-Management
Auditing-Internal	Income Taxes
Commercial Law	Principles of Industrial Engineering
Integrated Data Processing	Operations Research
Market Research	Principles of Business Management
Report Writing	Controllership Functions & Organization
Human Relations (Relations with Others)	
Business Organization and Planning	

It is apparent that some of the foregoing topics require further breakdown. Thus, for instance, Accounting-principles would include such courses as Elementary-Intermediate, Advanced Accounting, etc. Similarly, a breakdown of cost accounting would probably result in cost accounting principles and the application of cost accounting to management problems.

A question posed frequently is, "What can the controller expect from graduates of schools of business?" It is probably a fair statement that the following can be expected:

1. Disciplined intelligence
2. Some training in arts and science
3. Some specialization — depending upon the requirements of the particular school
4. Ability to communicate effectively

5. Ability to get along with people

The controller cannot and does not expect specific job training and job discipline.

The criticism which controllers most often voice concerning the lack of qualifications of graduates lies in the area of communications. There is perhaps no individual skill so necessary to the student going into the field of business as the ability to express himself clearly, logically and convincingly, orally, or in writing. For today's communication either prevents or creates tomorrow's problems.

Another deficiency mentioned by controllers is that students are not trained to think. They say that many students have little capacity for thinking through complex situations and formulating sound judgement.

As previously mentioned, one of the responsibilities of the school of business should be the development of administrative talents. It is clear that the student cannot be supplied with specific answers to the many situations which he will eventually face. If his education permits him to recognize quickly, to approach intelligently, and to solve the problem creatively, his training will have been significant and worthwhile.

Therefore, it is important to bring into existence a method of thinking rather than to provide ready-made answers for possible particular circumstances. Unless this principle is constantly kept in mind, it is quite conceivable that the educational program will deteriorate into one of mechanics rather than one to stimulate the developing of intelligent judgment.

In connection with the foregoing, it is appropriate to quote the concluding remarks of an address delivered by the late Dorothy Sayers at Oxford entitled "The Tools of Learning," who said that, "the sole true end of education, is simply this: To teach men how to learn for themselves; and whatever instruction fails to do this is effort spent in vain."

What then is the present status of controllership education and what needs to be done in the future concerning this area?

It is fair to say that although there is some criticism on the part of controllers concerning business education, this is not to say that collegiate education is all bad. On the contrary, much of it is very good and the schools of business are making worthwhile contributions in controllership education. There are many universities which make their contribution to controllership in the training of potential controllers. These universities also conduct evening schools and extension programs in which an employed individual may take both broad educational courses and technical courses.

An increasing number of universities are recognizing the need for training students in controllership education by offering courses or programs in this area. In order that more students may be offered this opportunity of training for controllership, it appears necessary that the 73 respondents who indicated that they offer no controllership course, determine the reason for not including controllership in their curriculum. It is hoped that a recognition on the part of these respondents, of the importance, the expansion of the controllership function in business and the need for students trained in controllership will initiate an objective review of the present curriculum resulting in the inclusion of controllership training. The controllership area is perhaps the biggest area which can absorb graduates. It would appear, therefore, that schools of business should offer the kind of comprehensive education which will prepare graduates to fill this demand.

In order that students can prepare themselves for this opportunity in the field of controllership, it is incumbent upon the schools of business to offer the student a choice between training in public accounting and private accounting. Some schools are making this training in private accounting available in the fourth year of study.

The following suggestions are offered with a view towards strengthening controllership education.

Controllership education could be strengthened by the use of businessmen and/or controllers as part-time instructors. While this area could be expanded, it is a fact that many controllers are already actively engaged in part-time instructions. A further point which could be considered is the employment of retired controllers as instructors. Such a program, if properly developed prior to the actual retirement of the controllers would bring a wealth of experience to the campus of many universities and would constitute a continuing source of capable instructors.

It is also suggested that more corporations give serious consideration to employing educators, either during the summer or a time mutually convenient to both, for specific project assignments and/or to observe the operation of business. Many corporations are already following such a program, but in order to be of maximum benefit to the area of business education, it is necessary that more corporations make this opportunity available to educators of schools of business.

It would appear that more schools could benefit by using outside speakers with broad industrial experience provided specific topics are assigned and some of the objectives of the controllership courses are discussed before the class meeting.

It is somewhat disturbing that only a very limited number of respondents arranged plant visitations. A visitation to a plant, followed by a visit to the controller's department and concluded with a meeting of company executives affords the students an excellent opportunity to obtain first-hand information concerning company policies of operations. Since many companies welcome the opportunity for arranging plant visitations, the question could be raised whether the schools have been sufficiently interested and alert in utilizing this very worthwhile educational aid.

The providing of opportunities, on the part of corporations, for students to enter into an internship program to obtain a better understanding of how the controller's department, in particular, and business, in general, operates, would be another contribution towards furthering controllership education.

Finally, it should be stressed that controllers are anxious to assist educators in the foregoing areas. In fact, many controls have already established a cooperative arrangement with schools of business in their area. Thus, controls have assisted in the establishment of controllership courses, made available subscriptions for *The Controller* and established annual outstanding scholastic achievement awards. Schools of business are urged to approach members of local controls in order that education in controllership may be strengthened.

It is my sincere hope that the survey will be sufficiently provocative so as to serve as a stimulus to educators to develop controllership course content and to train students in such a manner that they will be able to make a real contribution in the fulfillment of the following philosophy.

Ten Commandments of Management*

1. Identify the people of an organization as its greatest asset.
2. Make profit in order to continue rendering service.
3. Approach every task in an organized, conscientious manner so that the outcome will not be left to chance.
4. Establish definite long and short-range objectives to insure greater accomplishment.
5. Secure full attainment of objectives through general understanding and acceptance of them by others.
6. Keep individual members of the team well adjusted by seeing that each one knows what he is supposed to do, how well he is supposed to do it, what his authority is, and what his work relationships with others should be.

7. Concentrate on individual improvement through regular review of performance and potential.
8. Provide opportunity for assistance and guidance in self-development as a fundamental of institutional growth.
9. Maintain adequate and timely incentives and rewards for increase in human effort.
10. Supply work satisfactions for those who perform the work, and those who are served by it.

* LAWRENCE A. APPLEY, *Management News*, October, 1956

CHAIRMAN ASHER: Thank you very much, indeed, Hans Todt, for a very scholarly review of the controllership function, and for some very interesting comments. I think we can certainly all agree that Hans as Chairman of the National Committee on Education of the Controllers Institute of America is right there pitching, and believes what he says about the importance of the controllership functions.

We come to our next speaker, Robert N. Anthony. Dr. Anthony has been on the faculty of Harvard Business School since 1940, except during World War II when he was in the Navy, and 1957–1958 when he was in Lausanne, Switzerland helping to organize and teach in IMEDE, international school for middle management men. Currently, he teaches the course, "Administration and Review of Accounts;" is in charge of the School's continuing research project on business data processing; and leads a research seminar on "Return on Investment Problems."

He is the author of several books, including *Management Accounting*, a widely used case and textbook, and *Office Equipment: Buy or Rent?* He is co-author of, editor of, or contributor to several other books, and has written a number of magazine articles.

Dr. Anthony has done consulting work with a number of business companies, public accounting firms, trade association, and management consulting companies, and with various government agencies. He is President of Management Analysis Center, Inc., a consulting organization. He is Vice President of the American Accounting Association, member of Controllers Institute, National Association of Accountants, American Statistical Association, and the Institute of Management Sciences.

I talked with him at lunch time and he said he might take a pot shot or two at NAA. I am quite worried about how he is going to shoot me down. You may see some very unusual actions up here. Bob Anthony.

DISTINGUISHING GOOD FROM NOT-SO-GOOD ACCOUNTING RESEARCH

ROBERT N. ANTHONY
Professor, Harvard University
Boston, Mass.

I owe you an explanation for the rather offbeat title of this talk. The original plan was that I would talk about Accounting Research. However, the more I thought about this vast subject, the less able I felt to summarize either the present state of research or of some facet of it. In searching for a way out, it occurred to me that as users of the results of accounting research, we all face the problem of sifting through the tremendous quantities of literature to find useful new ideas, and that it might be fruitful for us to think about efficient ways of going at this task.

If we are to get anywhere at all with this subject, we must adopt a somewhat broader definition of research than Carman Blough gave this morning. That definition is applicable to the physical or biological sciences where research consists either of experiments or of clinical observations that tend to prove or disprove a hypothesis. In a research hospital, a researcher thinks of a new type of operation that he hopes will cure children born with a certain type of abnormality. He experiments, first with animals, then with children, and he reports in the professional journals to his colleagues the results of these experiments. At the Children's Hospital in Boston, for example, the doctors have been experimenting with ways of saving babies born with an obstruction of the esophagus, a defect which had led to death within two weeks after birth in every case in recorded history. In the 1930's, they worked on 100 such cases, and in every one of them the baby died. But a complete description of their procedures, and their suggestions for the future, were nevertheless fully reported in the medical literature. Then, in 1939, they had their first success. After 44 operations, and 1,100 days of hospitalization, a little girl recovered (and incidentally is alive and healthy today), and this was reported. Currently, I am told the procedure has been improved to the point where it requires only one operation and three weeks in the hospital, and there is an 80 per cent chance of success.

There is nothing in business comparable with this type of research and reporting. Rarely is there any mention in our literature of procedures which were tried and did not work. And even reports on successes are not documented in a way that would satisfy a medical researcher. We need not explore the reasons for the difference here, other than to point out that the anatomy and physiology of a business are vastly more complicated than those of a human being. But if we are to have any basis for discussing research in business, or in accounting, clearly we must have a different definition than the scientific one. I see no point, for our present purpose, in trying to be more specific than the statement: Accounting research is what is described in a serious paper or book on accounting.

So, let us assume that we have before us a journal article on an accounting topic of interest. It is of interest either because as businessmen or future businessmen we hope it may provide a new idea for the successful operation of our business; or because as advisers to business, it may be something of interest to our clients; or because as teachers, it may represent something that should be incorporated in our instruction. How can we decide whether the idea in the article actually is worthwhile?

I shall discuss this question under three headings: the journal, the author, and the evidence.

The Journal

Some readers place a great deal of faith in certain magazines. Now although I am proud to be a member of its Editorial Board, I cringe at the statement: "It must be so because I read it in the *Harvard Business Review*." We make no claim about the validity of our articles; indeed, we specifically disclaim any responsibility for the ideas in them. The current issue, for example, has an article on return on investment which in my personal opinion has completely fallacious conclusions. In the editor's opinion, however, the point of view of this article is one that businessmen should know about, and it is well argued. These are good enough reasons for running the article but the mere fact that it is run is not a good enough reason for believing it.

What, then, can the reader count on from the magazine itself? I think that the most that can be said is that if the magazine has a competent and a large enough editorial staff, you can have reasonable confidence in the factual accuracy of its contents: the numbers should add up, the equations should be in fact equal, the dates and other verifiable facts should be correct. But you cannot always expect even this. The *N.A.A. Bulletin*, for example, relies on manuscripts sent in by publications directors of its 150 chapters; each chapter must send in a certain number or it loses points in the annual chapter competition, and the harassed publications directors therefore try to pressure members to writing something—anything—to earn these points. From this flood of material, the editor in New York must pick 8 or 10 pieces every month to fill up the magazine. In such a rat race, it is scarcely surprising that there is a wide variation in the quality of articles, or that factual errors creep in.

All editors, being human beings, have biases, and sometimes a recognition of these can be useful in appraising the articles they run. This is a delicate point, and for safety's sake I shall illustrate it not with an accounting publication, but with the *Reader's Digest*. *Reader's Digest* articles tend to give the impression that there is nothing good about Russia, or China, or indeed most foreign countries, or most labor unions, or with (in quotation marks) the "government bureaucracy," and so on. It is not that their facts are incorrect; it is just that there is likely to be another side to the story that *Digest* articles omit.

The Author

If we see an article by someone we know and respect we naturally pay a great deal of attention to it. But suppose, as is usually the case, that the author is unknown to me. I then think it is quite important to find out about both (a) his background, and (b) his bias, before considering what he has written. I emphasize *both* background and bias. The partner of a public accounting firm, I assume, has a very good background in the accounting area, but if he writes an article describing a new technique his firm has developed and would like to sell to clients,I rather suspect that he is emphasizing the virtues and minimizing the weaknesses of this technique, and I read the article accordingly. Similarly, a press release describing the wonders of the new Model 999 computer is to be read somewhat differently from a reasoned analysis of the performance of such a computer by a graduate student, even through the graduate student has much less background on the subject.

An excellent example of how differences in point of view affect articles appeared in recent issues of the *Harvard Business Review*. In the March 1959 issue, we ran an article by Donald Gant arguing that long-term noncancelable leases are equivalent to debt, and that companies are greatly overrating their attractiveness as a means of financing. In the May 1959 issue, we had a strong rejoinder by Alvin Zises. In order to understand these articles, I think it is absolutely essential that the reader recognize that Donald Gant works for Goldman Sachs & Co., an investment banking firm, whose business of underwriting bond issues has not been helped by the growth of leasing, and that Alvin Zises is President of the Bankers Leasing Corporation. In saying this, I am not disparaging either the articles or their authors. As a matter of fact, I think Gant's article was the best one we ran in 1959. What I mean is that if one reads these pieces without keeping in mind the background and bias of their respective authors, he is not in a good position to make an intelligent evaluation of their contents.

Theoretically, professors should have the least bias of any group. They have nothing to sell, no axe to grind. Unfortunately, this theory does not always work out in practice, but even if it did, professors also tend to have inadequate backgrounds for dealing with the realities of business.

In January, 1953 for example, we ran an article by Professor Chris Argyris,[1] a social scientist, which was very critical of current budgeting practices. If you go back to the article, you will find that it was based on a study of three manufacturing plants. Careful reading of the article will show that all three of these plants used the old-fashioned *imposed* type of budget, one dictated by top management without the full participation of the operating personnel. It is therefore no surprise that the budget did not produce good results in these three companies. But Argyris, although undoubtedly unbiased, did not at that time know enough about business to realize that his selection of these three particular plants practically guaranteed that he would get the results he did get.

If professors of accounting could be as close to business as medical researchers are to their hospital patients, their reports would be ideal, but the facts of life are such that this is usually not the case.

The Evidence

We can classify accounting articles into four categories: (a) those not based on any evidence; (b) those based on the evidence of one company's experience; (c) those based on surveys; and (d) those based on experiments. I am intentionally omitting articles that use as evidence quotations drawn from the literature since we are interested in articles that describe new ideas, rather than a compilation of other people's ideas.

This paper is, frankly, an example of the first category. It contains no evidence to support its points, and you must therefore judge it in terms of whether the ideas seem plausible, whether the arguments are logical, and whether they jibe with your own experience. So it is with all similar articles, and these comprise a large fraction of those in the literature. I shall not dwell further on this category in general, but I do want to mention a special subcategory, operations research.

[1] Chris Argyris, "Human Problems with Budgets," *Harvard Business Review*, Jan.-Feb. 1953, pp. 97–110.

An operations researcher tries to construct a mathematical model of a business or some part of a business. By definition, this model cannot be an exact duplicate of the situation it purports to describe. The researcher must necessarily make simplifying assumptions in order to make the mathematics manageable, and having done so, he can make his computations and describe the results in an article in a publication like *Management Science* or *Operations Research.* These mathematical calculations are by no means the same thing as evidence. The mathematics should show precisely what will happen in the *assumed* situation, but what we are interested in is not the assumed situation, but the real life situation that is being modeled. The only way I know of to find out whether the mathematics is applicable to real life is to try out the results in a real situation and see what happens.

Thus, I am not very much impressed by a mathematical demonstration that has not been tried out in real life. Indeed, the first thing I do in looking at an OR article is to see if there has been an actual trial of the results. I may in fact miss some revolutionary new idea this way, but I save a lot of mental torture in wading through the formulas.

We professors run into this problem all the time with student reports. Just recently a colleague was telling me about a very elaborate scheme a student had worked out for determining how much a company should spend on advertising. The student took his proposal to the management of the company he was working with, and they studied it with some care and finally said: "This may or may not be quite valuable. Before we can judge it we need to have you tell us how we can get the numbers to fit into the equations you have built up." "Oh," said the student, "my job was to develop the equations; it's your job to find the proper numbers to fit into them." And since these numbers were nowhere in existence, that was the end of that.

This problem is by no means confined to students. My favorite example is a very learned article from the magazine *Operations Research* which applied probability theory, queuing theory, and Monte Carlo techniques to the problem of handling freight cars in railroad classification yards.[2] The researchers found that in the current practice, two operations were performed one after the other. First, the incoming cars were inspected for mechanical defects, and, next, they were classified into trains by shunting or humping them to the proper track. The conclusion of the mathematical analysis was that the railroad could save time and money ($100,000 a year) by carrying out the inspection at the same time that

[2] Roger R. Crane, Frank B. Brown, and Robert O. Blanchard, "An Analysis of a Railroad Classification Yard," *Operations Research,* Vol. 3, August 1955, p. 262.

the car was being humped. The researchers, however, did not make the slightest effort to find out whether the inspectors were in fact willing and able to inspect the cars while they were in motion, nor what new costs would be involved in transporting the inspectors back and forth. Without evidence on these points, the whole mathematical analysis is worthless.

Company Experience

The second category of evidence is that based on company practice. Now, I suppose that a true scientist would ordinarily not pay much attention to an idea supported by only one experiment. In business, however, we often do pay attention to results of this kind, and I think with good reason. If the new technique works, and *if* it works for the reasons we have postulated, this is a powerful argument in its favor. The catch is in the second "if." Why does the new idea work? Is it because it was an inherently sound idea, or was it for some other reason that we do not know about? The classic example of experimenters being misled by the evidence is the so-called bank-wiring studies at Western Electric many years ago. You will recall that the experiment increased the lighting in a room where women were wiring banks of telephone switchboards, and that with each increase in lighting there was a corresponding increase in productivity. The natural conclusion was that in order to get good productivity, you had to have good lighting. However, as a final experiment, they decreased the light levels to what they were when the experiments began, and to their surprise they found that productivity, instead of dropping, actually increased again. Eventually they concluded that it was not the lighting that caused the increase in productivity, but rather a reason that they had not even been studying, namely, the workers were impressed by the fact that the experimenters showed an interest in improving their performance.

This problem arises whenever an accounting technique influences or is influenced by the reactions of human beings. Thus, I am cautious about automatically attributing improvements in cost control, or whatever, to the particular technique being described in the article, and I would very much appreciate a description of the steps taken by the author to investigate whether the reported advantages are actually the results of the new technique, or whether they come from some other causal force. This is the basic weakness with nearly all articles on the topic of direct costing, for example.

The question of bias also comes up with this one-company evidence, of course. The person who thinks up a new idea and tries it out in practice is quite naturally fond of his brainchild. It is unreasonable to expect him to be completely objective about it, to seek out and confess publicly the weaknesses or qualifications that may lessen the apparent advantages. For this reason, the report of an outsider carries much more weight with me than the report of an actual participant in the experiment.

Often, it is not easy to determine whether or not the article does report actual practice. An article from the March 1960 *N.A.A. Bulletin* is a case in point.[3] The author is a systems analyst in a company, and some of his illustrative forms look like regular company forms, but nowhere does he say that his company is using the technique described. And this is a crucial matter, because he is describing a complicated technique for controlling research and development. A key question about such techniques always is the matter of whether the engineers have the ability and the willingness to make the detailed forecasts that are required. In the absence of definite assurance that these techniques have been tried and found practical, I must classify them as just another system man's pipe dream, and an engineer's nightmare.

Evidence from Surveys

Next, we come to evidence based on surveys. This is a subject on which many books have been written, and instead of attempting an orderly treatment of it, I intend to give only three practical criteria that seem to me particularly useful in judging whether to attach any meaning to the results of a survey.

First, I want some evidence that the investigator worked hard on the survey. A good survey is expensive. The questions must be written, discussed, tested, and rewritten. The best possible list of people or companies must be thought about and located. Followups and tests of nonrespondents must be planned and faithfully carried out. Analyzing the responses is much more than a mechanical job of tabulation. When an article describes a survey and the only statement about the survey process is "executives of fifteen corporations with a reputation for experience with profit planning were interviewed," with not one word about the selection of these companies, the length of the interview, the questions asked, or the particular persons seen, I am pretty hesitant to accept the reported results as having any meaning.

Second, I want to see the actual questions so I can make my own interpretation of what the answers mean. I have read three recent surveys on the extent to which companies use return on investment. One reports

[3] Cecil R. Hollis, "Programming for Control of Contract Performance," *N.A.A. Bulletin*, Section 1, March 1960, p. 19.

60 per cent[4] of respondents use the technique, the second reports 78 per cent[5] and the third reports 100 per cent.[6] One asked the vague question: "Does your company use the return on investment concept as a management tool?" In another, the exact question asked is not given in the report. The great difference between these results can easily be accounted for by the different ways in which the question was asked.

Incidentally, it is surprising how many investigators fail to distinguish between what the respondents say they do, and what they actually do, yet the existence of this difference is a well-known fact of life. In a recent survey on long-term leasing, for example, we asked investment analysts: "What procedure do you normally use to evaluate these lease obligations?" Seventy-seven per cent of our 256 respondents stated that they normally included lease payments as a fixed charge in computing coverage, or that they capitalized lease payments in computing balance sheet ratios, or both.[7] We thereupon sent 163 of these people a set of four little problems and asked them to make the calculations they normally make. From the responses to this second-stage survey, we estimate that considerably less than half of these people actually do use the techniques they said they used. The explanation is simple: on the first survey, many people checked the technique they thought they *ought* to use.

Third, for obvious reasons, I want to know the size and composition of the sample and of the respondents.

Given the above three pieces of information: good data about the survey process, the exact questions asked, and the survey size and composition, I usually can make up my mind about whether a survey has anything useful for me. Note that I have not mentioned tests of randomness of the sample, the size of the standard deviations, or other such matters which are discussed in courses in statistical sampling. These techniques are of crucial importance in public opinion polls, and I would pay no attention to a public opinion poll that did not handle them correctly. But in surveys of business practice, they are nowhere near as important. Other things being equal, a probability sample is a good thing, but the matters outside the straight statistics are usually much more important than statistical elegance. In fact, I know of one large government survey, involving hundreds of thou-

[4] Professor Dennis Gordon, University of Akron, Responses from 200 companies.

[5] Eugene Ladin, "Return on Investment Concept Applied to Air Force Central Procurement," Student Research Program of School of Business, Air University, August 1959. Responses from 76 companies.

[6] "Return on Capital as a Guide to Managerial Decisions," NAA Research Report 35, 1959, p. 6. Responses from 44 companies.

[7] Richard F. Vancil and Robert N. Anthony, "The Financial Community Looks at Leasing," *Harvard Business Review*, Nov.-Dec. 1959, pp. 113-130.

sands of dollars of money and thousands of respondents, that was severely crippled by the statistician's insistence on a universe defined in such a way that he could draw a random sample from it, rather than in a way that made sense in terms of the phenomena being studied.

Of course, the percentage of respondents to a survey who report the adoption of a new technique is not too important anyway. We are interested in new ideas, and if we wait until a *majority* of companies have acted, we shall be quite a way behind the leaders. The best guide, I think, is "Be not the first by whom the new is tried, nor yet the last to cast the old aside."

Evidence Based on Experiment

If business is to become a science, and if business research or accounting research is to have a meaning comparable to what it has in the physical and biological sciences, then my final category of evidence (evidence based on experiment) must eventually become the most important of all. Unfortunately, there is so far only a tiny amount of such research; and of the amount that is done, only a fraction is done by people who understand accounting or business well enough so that we can profit by the results.

I shall mention two examples. One is a study made by Jack Grayson at Harvard.[8] This is the very first set of actual experiments bearing on the question of whether businessmen can in fact estimate a reasonable utility function, something which they must be able to do if the new statistical decision rules involving utility are to have any practical application. The second is the study by Andrew Stedry of Carnegie Tech.[9] Here is a pioneering attempt to test by actual experiments the validity of some of the long-standing folklore people have had about budgeting. For example, is there actually some advantage in having a tight budget over a loose budget? Although I cannot entirely agree with the validity of the experimental evidence or of the mathematics given in other parts of Stedry's study, these possible weaknesses are nowhere near as important as the fact that the attempt was made. These are examples of the type of research we need much more of.

Conclusion

In my comments and examples above, you will note that I have confined myself to management accounting, and have said nothing about re-

[8] Charles Jackson Grayson, Jr., *Decisions Under Uncertainty: Drilling by Independent Oil and Gas Operators.* (Harvard University Graduate School of Business Administration. George F. Baker Foundation), September 1958.

[9] Andrew C. Stedry, *Budget and Control and Cost Behavior,* May 1959.

search in financial accounting theory. This was intentional, since the two problems are quite different. In fact, I doubt that much useful research in financial accounting is possible until the profession has made up its collective mind as to what the basic ground rules—the postulates—of accounting are to be.

Let me recapitulate: Your attention is attracted to a new idea in an article, and you are trying to make up your mind as to whether the idea has merit. I have suggested that you cannot get much help from the prestige or reputation of the magazine itself, but must rely principally on your appraisal of the author and of his evidence. I have suggested that in all cases where the author is unknown to you, evaluation of his bias and background is essential. With respect to the evidence, I have urged a sharp distinction between a theoretical description of "what might be" versus a report of what actually happened, either in a single company or in a group of companies.

You may note an underlying tone of dissatisfaction with the state of accounting research. I *am* dissatisfied. Powerful forces are at work to push a tremendous volume of worthless material out upon us: the pressure on professors to "publish or perish," the childish point system of the National Association of Accountants, the belief on the part of firms that publications is an effective form of advertising, the absence of any professional standards of what constitutes acceptable research in accounting, the lack of a system of professional review of manuscripts, the unwillingness of the business community to support the expensive and time-consuming process that is essential to sound research, and so on. The recent N.A.A. statement of *Objectives and Methods of Research in Management Accounting* adds to this feeling of dissatisfaction. We must have higher sights and higher standards than those outlined in that document if we are to make real progress.

The Grayson and Stedry projects mentioned above are two gleams on the horizon, signs of what I hope will be a much stronger tendency in the future. But the question of how to hasten that happy day would start me off again, and it is time to stop talking.

CHAIRMAN ASHER: I agree with you, Bob, it is time to quit. That was a very splendid and thought-provoking talk on this matter of research. There is a great deal of attention, and you heard about it this morning from Carman Blough in this matter of research in accounting and in business subjects.

This last January the Presidents of the American Institute of Certified Public Accountants, and the Controllers Institute and myself had a meeting together in New York to discuss this particular point as a major part of our agenda, namely, the necessity for beefing up substantially the quality and also the quantity of good research.

I think, Bob, you have very definitely pushed this little needle out around here this afternoon. We feel its effect, and it will help us in our review of material. Also, I am very happy to observe that you have referred to our readership of the N.A.A. bulletin. I would like you to know that in my briefcase when I came last night, I brought two magazines. One was the *Harvard Business Review*; the other was the *Arizona Highways* magazine. The one I read was the *Harvard Business Review.*

We now come to the last speaker on this very fine program this afternoon. His is Laurence W. Acker of Washington. Things have changed rapidly, as you have heard from this platform today, and this is true also of Mr. Acker's case. According to the printed material he was Deputy chief of the Army Audit Agency. He is now Director, Accounting and Finance Policy, Office or the Assistant Secretary of Defense (Comptroller). Mr. Acker will take office July 1 as the National President of the Federal Government Accountants Association, following his recent election by the organization's 3,500 members.

He is a certified public accountant with 25 years in federal service. Mr. Acker held previous accounting, auditing and budgeting assignments with the wartime Office for Emergency Management, U. S. Department of Agriculture, General Accounting Office, and General Services Administration. He was appointed to his present post in 1952, which now has changed. He was Deputy Chief, Army Audit Agency. I am very pleased to report to you that as he was leaving that position for the one he now holds, he was awarded the Army's Exceptional Civilian Service Award, the highest award the Army can give a civilian. I think here and now we owe him a little hand of applause. (Applause)

Mr. Acker is a native of Tyler, Texas, a member of the American Institute of Certified Public Accountants and a faculty member of the U. S. Department of Agriculture Graduate School. And, of course, as we have reported, he is the incoming National President of the Federal Government Accountants Association.

He has a very timely message for us. I think Khrushchev's recent blasting makes this a little more timely than might have been anticipated. He is going to talk to us on the subject, "Improvements in Control of Defense Resources." It is a very important subject, and I am very happy to introduce Mr. Laurence W. Acker from Washington to you at this time.

IMPROVEMENTS IN CONTROL OF DEFENSE RESOURCES

LAURENCE W. ACKER

President, Federal Government Accountants Association
Deputy Chief, U. S. Army Audit Agency
Washington, D. C.

When I was a child I often heard it said that the Government would spend $1,000 to run down a penny—a lost or misappropriated penny. Even in those very early days this seemed to me to be a little disproportionate. Somehow it led to the notion that the Government thought more of its pennies than it did of its dollars. Accordingly, it led me to save pennies where now I wish I had saved dollars.

Apparently the thought still exists that the Federal Government deals extensively with the minutia and the trivia, that it still struggles desperately with its pennies, that it overcontrols in its cash and in various facets of its fund accounting, that its financial and managerial controls are not adequately applied to its human and physical resources. In specific cases that is true; in a general or relative sense, I think it is not true. Putting it another way, I believe that considering the magnitude, the dispersion, and the diversity of governmental functions, a remarkably good job is done in safeguarding and using the taxpayer's dollar and the things that dollar buys.

Now, let me orient this discussion toward Defense. For the next fiscal year we have a Defense budget of something more than $39 billion. That is more than $1,000 a second—more than 100,000 of those pennies each second. Now, within Defense let me orient the discussion somewhat toward Army where I have spent almost the last eight years as the principal professional director of its audit activities.

The personal property inventories in Army exceed $19 billion—almost equal to the amount of goods in retail trade in the United States.

There are more than 870,000 men and women wearing the Army uniform. Add another 700,000 in drill-pay status in the National Guard and Organized Reserve units. Then, the Army employs more than one-half million civilians, and more than 100 thousand foreign nationals.

The Army's establishments are spread throughout the United States and 75 other countries. Its business-type activities necessarily include almost every type of human endeavor: education, merchandising, industrial activities, communications, transportation, just to mention a few. All these are necessary to support the ultimate mission of the Army: success in combat.

These figures create an impression of "bigness"—big business, big organization, big problems. As an illustration, a public accounting firm would not often be confronted with the observation and verification of a $2 billion inventory. Yet, this is not unusual in the business of national defense. Few, if any, industrial concerns deal with the numbers of line items in inventory common in the military. None is faced with the problem of calculating and maintaining adequate reserves to supply needs in event of mobilization. While the basic principles of financial control are essentially the same, adaptations of concepts and procedures are required to meet the specific needs and objectives of the military organizations.

The Navy and Air Force are not being overlooked in sticking to Army statistics. The problems are relatively the same and the dollar amounts will vary upward or downward according to the function considered. But as mentioned, I served the Army in a civilian professional field for almost eight years and can speak more to point on its functions. During this time, I was a critic—a constructive critic I hope—in pointing out weaknesses and deficiencies in areas where improvements are needed.

As a critic, it was perhaps natural to gain a deeper appreciation of the mountainous problems, the complex decisions, and the internal and external stresses. Along with this it was perhaps natural that one would gain greater respect for the dedicated people who devote their energies to do a job which often brings little reward, and sometimes only frustration and exhaustion.

The audit organization was one of the improved controls which made possible a better use of the Army's resources. It brought the results of its examinations of the far-flung activities of the Army up through succeeding levels of organization to the Army's staff and secretariat so that better, more informed managerial decisions could be made or corrective action could be taken. Audit serves as a control which functions by measuring and evaluating the effectiveness of other controls.

There have been continuing improvements in controlling Defense resources (which I will comment on in a moment), but let me pause to ask why—why this expenditure of money—why this dedication of so much of our national economy to the Defense effort?

There are others who can answer better than I, so let us let them speak.

Some time ago the Vice-President of the United States spoke before the American Legion at Minneapolis. He said:

> "I have made a comprehensive study of the philosophy, tactics, and strategy of communism, as set forth by Marx, Lenin, Stalin, and other Communist leaders. On the basis of these studies I know that Communists throughout the world are united in working for one objective—Communist rule over all the people of the world."

The words of Mr. Allan Dulles, Director of Central Intelligence Agency, were paraphrased before this same meeting of the American Legion by General Cabell in this way:

> "Our defense lies not in compromise, but in understanding and firmness, in a strong and ready deterrent military power, in marshaling of our economic assets with those of other free countries of the world to meet Communist methods of economic penetration and finally in the unmasking of Communist subversion.
>
> "If they succeed and we fail, it will only be because of our complacency and because they have devoted a far greater share of their power, skill, and resources to our destruction than we have been willing to dedicate to our own preservation."

Speaking before the National Association of Manufacturers in December 1959, Mr. Wilber M. Brucker, Secretary of the Army, said:

> "From the earliest days of Lenin's dictatorship, the communist conspiracy has been characterized by patience and cunning in the planning and execution of its program. The communists have long realized, for instance, that a most important avenue toward success in attaining their goal lay in seeking out sore spots and weaknesses in susceptible political, economic, and technological areas throughout the world, and taking ruthless advantage of them through military pressure, deceit, propaganda, terror, and subversion.
>
> "Although since 1953 the communists have placed major external emphasis upon so-called 'peaceful' penetration of the Free World, we know that they have not neglected their war machine, the most powerful mobilized military forces on earth. Concurrent with the political, economic, and psychological maneuvering by which over the years they have acquired some five million square miles of territory, and subjugated over 600 million people, they have strengthened their capability for all kinds of combat."

This, then is why we spend the sums which seem almost astronomical. That is why we are called upon to put back in taxes so much of what we receive from the Government as employees or vendors of services and materiels. In this gigantic game of put and take, the stakes are peace, prosperity, and most precious of all, freedom. I think I echo the viewpoints of the vast body of people both within the Government and outside who are contributing to the Defense effort, in asserting that a dedicated, intelligent, and increasingly successful effort is being made to manage and control the resources at our disposal.

Now let us consider some improvements in concept which have led to wiser, more effective use of our Defense resources. I will not attempt to go into the details of accounting and budgetary actions and controls. These are important to those of us who work with them, but a technical recitation might bore you.

Our basic resources are often referred to as men, money, and material. Let us start with the money.

Historically, Congress has appropriated funds for each fiscal year on what we call the obligation basis, that is, funds for orders to be placed for goods or services during the fiscal period. Obligations are not the same as costs, at least not necessarily so. The emphasis, consequently, in the legislative and executive department of the Government has been on managerial control of funds through limiting the amount of orders which could be placed for goods or services. Public Law 863 established requirements for certain improvements which will have a significant effect on maagerial control of resources. Policies and principles designed to meet the required objectives have been published in the form of a directive for the operation-and-maintenance area. Since each major program area will require certain variations, additional directives are in process.

The employment of cost concepts in controlling operations and preparing budget will lead to increased economy and efficiency. The Army, for example, is already budgeting accounting and reporting on a cost basis at certain levels in a wide range of its activities with reconciliation of costs and obligations for each budget program. Its financial management plan is designed to give Congress a cost of performance or functional budget that shows the costs of Army actions and activities.

A moment ago I mentioned that different types of Defense activities require different approaches in the control of resources. It might be useful to elaborate upon this point briefly.

Military activities of the combat and combat-support type are unique. They have no counterpart in business. Military personnel is a big item of expense in this area, and at the local levels, military personnel costs are not controllable. These are controlled at higher levels based upon such techniques as tables of organization and distribution, ration allowances, etc.

In the Army, predetermined strength or force levels substantially control military personnel costs. In the Navy and Air Force, the numbers of capital-type items to be operated: bombers, ships, fighters, etc., have a relationship to the size of the force required.

The administrative activities of the military departments include the operation and maintenance of posts, camps, stations, airbases, etc., all wholesale supply and distribution systems, administrative offices, procurement and inspection offices, military headquarters, departmental offices, and the like. Generally, the same control devices used in private business can be applied to these activities with little or no modification. Military personnel costs in these activities are controllable at local levels.

The procurement and management of inventories of equipment and supplies fall into two major groups: capital-type items and consumable materiel. The capital-type items include ships, planes, missiles, production equipment, vehicles, and the like. Consumable materiel includes an almost unimaginably wide range of items numbering into the hundreds of thousands. Included among these are such things as fuel, clothing, subsistence items, ammunition, and the like.

Capital-type items are characterized by long production lead-time. Procurement of these items, therefore, often extends into two or more fiscal years. Budgeting, funding, procurement, and management of these items are centralized under the responsibility of the commodity or inventory managers of the respective departments. These inventory managers are not usually located at their departmental headquarters, but instead maintain their headquarters at field stations located in areas of concentrated activity. Financial management in this area starts with budgets on several bases for each fiscal year. These are:

(a) Estimated total costs of specific end-items proposed for procurement (tanks, bombers, ships, and the like).
(b) Obligations estimated to be incurred during the fiscal year (an element of executive agency — not Congressional — interest).
(c) Estimated delivery schedules by fiscal year for the proposed procurement.
(d) Estimated expenditures for the fiscal year.

Thus, the program for improvements starts with cost-based budgeting. It gives adequate consideration to control of obligations, on a fiscal year basis, and recognizes the necessity for control of rate and amount of expenditures. On the last point, the impact of Defense spending on the Treasury cash position is so substantial that forward planning and control are essential.

Consumable materiel is, for the most part, centrally procured. For the most part this materiel is initially procured by the stock funds of the respective military departments. Although these stock funds are under centralized policy control, they are physically dispersed so as to be as near as possible to the ultimate user. The ultimate user fills his requirements through purchases from the stock funds. Cost concepts in budget preparation and in operational control are exceptionally important in this area. The inventory turnover rates are relatively high and the dollar values involved are tremendous. Substantial progress is being made to introducing cost concepts as important factors of managerial control, not only for the local manager but for the departments, the Bureau of the Budget, and the Congress. I have already spoken of some of the improvements effected and in progress in the financial control of our manpower and materiel resources. I would like to add a few words, however, in a different vein.

Continuing improvements are being realized in the quality of the manpower resource, both military and civilian. The school systems of the respective departments have continually improved. Selection processes are better than ever. A number of wise, forward-looking actions are being taken which will result in further improvements. Career programs for civilians are being placed in effect. The Army Audit Agency is an excellent example. Through objective training, diversification of assignment, and rotation from one location to another, the staff of the Agency is being improved and developed to permit assignments of greater responsibility. Of course, with such assignments come better pay for the individual. The Comptroller of the Army has in effect a career program for civilians engaged in comptrollership activities throughout the entire functional area. It provides for greater recognition and increased responsibility for those who demonstrate effectiveness and ability. Congress last year authorized expenditure of appropriated funds for training of civilian employees, in appropriate cases, in order that the quality of the manpower resource could be further improved. It is widely recognized that in the final analysis the best of systems and the best of equipment cannot perform effectively without a competent trained man or woman to activate and maintain them. Continuing improvements of this kind will lead to a more effective work force and, in turn, to greater efficiency and economy in the conduct of Defense and other governmental activities.

The satellites that transmit photographs to us and give us reports on conditions in space could be cited as illustration of improvements in the materiel field. There are others less glamorous, perhaps, but significant. For example, the new Army rifle, the M-14 (you may have heard that it replaces four weapons: the M-1 Garand rifle, the M-2 carbine, the M-3 submachine gun, and the Browning automatic rifle). As Army divisions are equipped with this new weapon, they will have greater effectiveness, more fire power, but fewer weapons.

Along with the improvements in materiel have come improved managerial controls of materiel. These have come about through such devices as the stock funds, already mentioned, through improved policies and procedures, and through the utilization of electronic computers in stock accounting and control. Paradoxically, however, these advances and improvements seem to bring new problems. As an auditor, I have participated in examining and commenting on the property in Army's inventories which was excess to its needs. I was struck by the fact that though there were instances where some degree of mismanagement or other deficiences resulted in the creation of excesses, there were other reasons of a more palatable nature. As an example, when the Army converted to the pentomic divisional structure in 1956, it decreased the size and organization of the typical Army division and increased its effectiveness and fire power by assigning different equipment. Naturally, these actions created excess equipment, which in the Army's accounting records looked like any other excess. However, this was a deliberate move — a part of the program of modernizing the Army.

Exploding technology is bringing benefits — and problems — to all the military services, and to other governmental agencies as well. The scientists and engineers are creating obsolescence in combat and other equipment. We are reaping the benefits in terms of a far more effective defense storehouse. Too, we are reaping by-product benefits in terms of better things to use in our daily lives. But, these things cost money, and create new problems.

It is a far cry from the Gatling gun to the M-14 — from the Merrimac and Monitor to the Forrestal or the Skate — even from the B-29 to the B-36, which has been superseded twice in peacetime, and we are now reading about the proposed B-70. I have seen the engineer's transit and chain replaced by equipment based on radar principles which can accurately measure line of sight distances. I have seen other equipment measure intercontinental distances by electronic viewing of stars. Now we have the beginning of a satellite system by which navigators can determine positions with unbelievable accuracy, even in cloudy weather.

As these advances occur we must utilize them to maintain our position in a competitive world. We must replace obsolete equipment (and along with it goes the spares and repair parts), a costly but necessary investment in progress.

It is in such an environment of change — explosive change — that the military services work. There is a struggle on the one hand to keep the leadership in the art and equipment of defense, and on the other to make the dollar go as far as it possibly can. At the same time, while gaining command of new technologies and new equipment, the old equipment has to be disposed of. This is the area where criticism and misunderstandings arise, often not justified.

Improvements in managerial methods are being made, and will continue. Managerial technology must keep pace with scientific technology. As citizens we are justified in taking a dim view of excess property or other unwarranted costs arising from mismanagement. Criticism of these things is healthy. On the other hand we have an obligation to understand that these situations can and do arise in a legitimate way. Often we become aware of the situations without learning the reasons behind them.

Though I have stood before you this afternoon as a Defense employee whose job for the last eight years has been to criticize and report on weaknesses, deficiencies, mismanagement, and the like, I can honestly repeat that considering the magnitude, the diversity, and the geographic spread of Defense activities, a remarkably good job is being done in the continuing improvement in policies and methods for safeguarding and using the taxpayers' dollars, and the things those dollars buy.

CHAIRMAN ASHER: Thank you very, very much, Mr. Laurence Acker, for that very fine review of education, processes, and controls in the defense establishment. I am sure we are all delighted to hear about these developments, and we are grateful that there are individuals like you in the government service.

And now, before we conclude this afternoon's session, I think you will agree with me that we have had a wonderful trip. We have really covered some broad territory, controllership. We have had a few needles thrown around here by our friend, Bob Anthony, and we have had a very fine review of what is going on in the Department of the Army and the Department of Defense. As we close and adjourn this meeting, I suggest we owe a round of applause to our three wonderful speakers of this afternoon's session. (Applause)

The meeting is adjourned.

FOURTH SESSION

THURSDAY, MAY 19, 7:00 P.M.
The Ohio Union—East Ballroom

Presiding:

DEAN JAMES R. MCCOY, *College of Commerce and Administration The Ohio State University, Columbus*

Greetings:

GORDON B. CARSON, *Vice-President, Business & Finance; Treasurer, The Ohio State University, Columbus*

Paper: "The World's Biggest Balance Sheet"

MAURICE H. STANS, *Director of the Budget, Bureau of the Budget, Washington, D. C.*

Presentation of the distinguished accountant elected to The Accounting Hall of Fame by WILLIAM M. BLACK, *Chairman, Board of Nominations; Partner, Peat, Marwick, Mitchell* & *Co., New York, New York*: to

MAURICE H. STANS

FOURTH SESSION

CHAIRMAN JAMES R. McCOY: Good evening. It is indeed a pleasure to welcome you to the banquet session of the twenty-second annual Institute on Accounting. Each year we are fortunate to have a considerable number of our friends join with us on this occasion to consider some of our common problems and explain points of view.

Tonight it is my privilege and honor to serve as your Chairman, and while I am sure everyone in the room is important enough in his own right to merit an introduction, time will not permit it. I am happy to say, though, that I believe I could introduce most of the people at most of the tables without notes, and I am happy to see you all here.

I would like to introduce an old friend, who for many years has performed the task that is mine tonight, Dean Emeritus Walter C. Weidler. (Applause) And Mrs. Weidler. (Applause)

It is also my pleasure to introduce the charming ladies seated immediately in front of me. I will ask you to withhold your applause until they have all been introduced. Mrs. Maurice H. Stans, wife of our speaker this evening; Mrs. Paul E. Fertig; Mrs. W. J. Fleig; Mrs. Russel S. Wilcox; Mrs. Frank L. Arnold; Mrs. Frank V. Olds; Mrs. Ralph Johns; Mrs. Ronald Daly; and my wife, Mrs. Mary McCoy. (Applause)

The distinguished gentlemen at the speaker's table, on my right: Mr. Frank V. Olds, Assistant Controller, Chrysler Corporation, and a speaker on tomorrow morning's session. Mr. Robert N. Anthony, Professor of Business Administration at Harvard University, and a speaker this afternoon. Mr. Hans C. Todt, Controller of Bristol Laboratories, Syracuse, and a speaker this afternoon. Robert A. Draper, President of the Ohio Society of Certified Public Accountants, partner of Konopak and Dalton, who presided at today's luncheon. Frank L. Arnold, Vice President of the American Institute of Certified Public Accountants, partner of Arnold, Hawk and Cuthbertson, who presided at this morning's session. John T. Mount, Vice President of The Ohio State University Board of Trustees. Dean Everett Walters, Dean of the Graduate School, The Ohio State University.

Charles J. Gaa, President of the American Accounting Association, who will preside tomorrow. John H. Herrick, Executive Director, Office of Campus Planning, member of the President's Cabinet, The Ohio State University. Laurence W. Acker, President of the Federal Government Accountants Association, Deputy Chief of the U.S. Army Audit Agencies, Washington, speaker this afternoon. John Peoples, partner of Peat, Marwick, Mitchell and Company, a speaker at this morning's session. Wallace M. Jensen, Partner in Touche, Ross, Bailey and Smart, Detroit, a speaker at tomorrow morning's session. Ralph Johns, partner, Haskins and Sells of Chicago, a speaker at this morning's session. Albert H. Cohen, Manager, Tax Department, Price Waterhouse and Company, New York, a speaker at tomorrow morning's session. John B. Fullen, Alumni Executive Secretary, Ohio State University. Paul E. Fertig, Chairman of the Accounting Department, Ohio State University. (Applause)

At this time, it is my pleasure to present to you Dr. Gordon B. Carson, Vice President, Business and Finance, and Treasurer of the Ohio State University, who will bring official greetings from the University. Dr. Carson. (Applause)

DR. GORDON B. CARSON: Mr. Chairman, distinguished guests, ladies and gentlemen at the twenty-second Institute on Accounting.

I do not suppose it is necessary for me to do what seems to be necessary at some of the events we hold on this campus. It was just the other day we had an event in this room, and upon leaving I heard one of the members of the group say to another, "Isn't it awful how these state universities squander the taxpayers' money? Just look at this building."

I have news for them. There are no tax dollars in this building. This building is entirely supported by fees on the part of students. The students voted to tax themselves these fees back about 1946, knowing full well that during the course of their career they would never benefit by it, but the procedure set up the down payment on this facility, which made it possible. So student fees continue to support it — no tax dollars.

I know that is completely redundant, because Jim tells me that many of you have been here many times, so I would like to say that in the ever-widening horizons of higher education this University (which is both a land grant University and the state University of Ohio), takes on the role of providing the people of Ohio and the Midwest with information and knowledge far beyond that provided in the ordinary classroom procedure. Hence, we are most happy to welcome the Institute on Accounting, along with other institutes which come here for this purpose.

We like to point out the fact that we are not very large as a University, because so many people accuse us of bigness, as if it were immoral. We are not big. We have 23,000 students who happen to be located on this campus, but they are in 10 different colleges and a graduate school. The numbers, therefore, per college are not astronomical.

A new look has occurred here, which some of you have seen. We are reaching for excellence in academic achievement in ways never before understood in state universities. Why? Because the total fund of knowledge is increasing so rapidly that we must be better, and our students must be better, if they equip themselves for the world of the next 40 years.

So with this background, and with this understanding of our mission, we hope you enjoy this meeting, that you find in it information, stimulation, and beyond that, inspiration as you go back to your respective important posts. We hope you will enjoy it. We hope you will be challenged by it, and that you will come again, and often. (Applause)

CHAIRMAN McCOY: Thank you, Dr. Carson. It is my pleasure tonight, and privilege, to present the Honorable Maurice H. Stans, Director of the Budget of the United States government.

Mr. Stans assumed this office on March 18, 1958, having served for four years and six months as Deputy Director prior to the appointment. He has had a notable career, and I am sure it is known to most of you, but permit me to read a few of the high spots for the record.

Before coming to the Bureau of the Budget in September 1957, he served as Deputy Postmaster General. During this time, he took a major part in the planning and directing of the reorganization of the postal service and modernization of the Department's management structure and operating practices.

His first experience in the federal government was in 1953, when he served on the task force in reviewing the federal budget for fiscal 1954. He was engaged for more than a year in a special study in postal fiscal systems, in accounting practices for the Postmaster General. Prior to entering government service, he was executive partner in the national accounting firm of Alexander Grant and Company.

He holds the degree of Certified Public Accountant in eight states. He has had an outstanding professional career, and received the American Accounting Award in 1952, and the American Institute Award in 1954. He served the Institute as President, and has been a member of the National Association of Cost Accountants, and the American Accounting Association, and the Federal Government Accountants Association.

My 13-year old boy is perhaps most impressed by his experiences as a big game hunter; his pictures were presented in *Life* a few months ago. I am not so sure but that his experience in those jungles may have stood him in good stead.

It is my pleasure to present to you the Honorable Maurice H. Stans. (Applause)

THE WORLD'S BIGGEST BALANCE SHEET

MAURICE H. STANS
Director, the Bureau of the Budget
Executive Office of the President
Washington, D. C.

Anyone who has studied the operations of the Federal Government knows that it is an enterprise of prodigious variety and dimensions.

It has the biggest budget, the biggest debt, the biggest payroll, the biggest farm subsidies, the biggest rent bill, the biggest overhead, and the biggest shopping list of wants and desires. It is the biggest lender, the biggest taxer, and the biggest borrower, in history.

Now, with all this bigness, a professional accountant would naturally suppose that the world's biggest enterprise would possess the world's biggest balance sheet, a veritable panorama of information to tell us where we stand on our assets, our liabilities, and our net worth.

It may surprise you to know that there is no such financial statement for the Federal Government.

You might suppose, as I confess I did a few years ago, that the books of the Government would be set up in such a way that a certified public accountant could get at least the glimmer of an idea as to what a Federal balance sheet might look like. I find, instead, that there are many reasons why such a document does not exist at the present time. There are masses of information and figures, but they are not organized for this purpose. We simply do not have the machinery in existence to pull together all the data needed for a comprehensive single picture of this tremendous enterprise we call the Federal Government.

But that is not anyone's fault and it is not necessarily fatal. And a full-fledged Federal Government balance sheet might be more misleading than helpful.

Let us consider some of the more obvious problems for just a moment.

How would you record the value of oil deposits in the continental shelf? What is the proper carrying value of the millions of acres of Federal public domain? Are our surplus farm commodities, bought at high prices, to be classified as assets or perhaps even as liabilities? In the case of commitments, what do we record for potential future costs—from the Federal Deposit Insurance guaranties on the one hand to veterans' pensions and civil service retirement on the other? Do we write off a hundred billion dollars worth of defense materiel as nonproductive inventory, or carry it at full replacement cost? How would you set a cost or a value on the Gettysburg battlefield, or figure depreciation on a B-52?

The accounting and valuation issues present almost insuperable problems, as you can see. And yet all logic tells us that within the larger setting of our national economy, the development of a proximate measure of the changing investments and liabilities of the Federal Government has an undeniable significance. Certainly we concede the important effects on the Nation's economy of the Government lending, research, procurement and disposal. We know how sensitive the private economy can be to actions taken or even rumored in the Government. For example, whenever there is the slightest move to sell off excess materials from the Federal stockpile, the affected industries usually set up instantaneous counter-defenses. How would you reflect these unwanted materials in the stockpile in any Federal balance sheet?

And yet I return to my conviction that a government, like a good business enterprise, does need a convenient way of summing up at least some of the significant features of its financial position periodically. It needs to know the extent to which resources devoted to government have increased or decreased, and the way in which their composition has changed in response to public demands. It needs to know what obligations it has taken on down the road.

The stockholders (the taxpayers) need a more reliable set of measures by which to gain perspective on what is happening in these respects in government—some better insight than the welter of claims and counter-claims of partisan organizations. If there is one paramount end to be served by an effort to produce more financial information on government than an annual budget, it is this objective of public accounting in a democratic society. Government is taxing too much, spending too much, and growing too much to continue to keep its accounts figuratively in a cigar box.

This is why I have sought so earnestly, in my two years as Budget Director, to bring out fiscal facts—on spending, on committments and liabilities, on trends,—and to bring them to the American people. That is why I accepted the invitation to speak to you tonight on the unusual title of "The World's Biggest Balance Sheet." It gives me an opportunity to summarize for you some tendencies and some circumstances that give me concern for the future, unless an enlightened American public will take the time to learn these facts and make its views on them known in the democratic way.

I propose to talk to you tonight about our Federal budget and our Federal liabilities—and how and why they grow! And, to make it all more meaningful, I would like to do so not in the narrow terms of millions or billions of dollars, but in the context of the conditions facing us in today's uneasy world.

Factors to be Weighed

As I see it, there are four present major circumstances that must be taken into account in planning our future course.

First, Mr. Khrushchev has broadened the Soviet challenge. He tells us the Soviets have chosen the economic battlefield rather than the military. He has pledged all of the energies of the Soviet system in his drive to make us a secondclass economic power. He says he will prove that capitalism and our free democracy are obsolete and he predicts that his system will bury ours.

Next, our continuing unfavorable balance of payments, which ran about $4 billion in 1959, has elements of danger. Whether or not those dangers develop depends on how we maintain the world's confidence in us, namely, in our ability to manage our fiscal affairs, and to maintain a strong dollar. We have become the world's banker with large balances of short-term credits. If we run a poor bank (if we do not manage our finances tightly), we can lose that confidence, and the results can be serious to our gold supply and to our money and our national vitality.

Third, so far compensatory fiscal policy has not worked as it was supposed to work. Whenever we have a downspin we accelerate government spending and borrowing, to pull ourselves out. When equilibrium is restored, however, we seem to lack the fortitude to curtail spending to provide a surplus for paying off what we have borrowed during the emergency. If we continue along this road our national debt is bound to go up and up.

And fourth, the shadow of inflation is always stalking us. The fact that we have held it off so well the last few years is not a reason for relaxing, because the danger persists. United Nations figures show that 29 out of 68 free countries (almost half) have had price increases of 50 per cent or more in the last 10 years. I do not need to tell you what this has meant in the loss of values of savings, insurance, pensions—in suffering and loss of opportunity.

These four circumstances mean that we need to do some hard thinking. As Americans do we now recognize two aspects of national security—economic as well as military? And are we strong and secure against economic surprise as we are militarily? Can we risk the perils of flirting with inflation? Can we continue to demand more of government than we are willing to pay for in taxes? Can we allow ourselves any longer the delusion that if money comes from Washington somebody else provides it? Can we fight with full strength under a tax load that discourages incentive, and a vast public debt which grows and grows?

These are just some of the realities that we cannot ignore as we put together the balance sheet of our values, and as we count our resources in preparation for the tremendous exertions that face us as a Nation. And here are some other *Facts to be Remembered.*

The progression of Federal spending over the past 30 years has been nothing short of precipitous. In 1930 the budget was $3 billion. By 1940 it had tripled to $9 billion. From there it shot up to $40 billion by 1950, and here we are in 1960 with budget expenditures of almost $80 billion. That represents a 25-fold increase in Federal spending levels in just three brief decades. If the progression of the last 10 years were maintained, we would have a Federal budget of $160 billion by 1970. I hope it will *not* happen, but we have shown that it can happen.

I ask you to realize that when you look only at the budget for one year at a time, you see just the surface portion of the iceberg; the dangerous part of it is under water. The brutal truth is that we have made our job unnecessarily and grieviously difficult, and we have already laid heavy burdens on our economic future that almost destroy our flexibility for choice. Here are four hard facts to bear in mind:

Fact Number One is that the Federal Government is piling up C.O.D.'s faster than most people realize. Here are just a few:

Merchant marine subsidies and ship replacement costs constitute a Federal obligation of $4.3 billion.

The Federal Government is committed to contribute $5.5 billion for the future for public housing.

Federal civil public works projects already started will require expenditures after 1961 of about $7 billion before they are completed, and there is a backlog of $13 billion of projects that have been authorized but not yet begun.

It will cost over $30 billion to complete the interstate highway program.

These and a variety of other obligations, coupled with huge unexpended balances in the defense program, total about $100 billion of commitments or C.O.D.'s for future spending.

From a balance-sheet standpoint, many of these expenditures would add to our assets, and we can pay for them through the years. That is the brighter way of looking at it. But this is not all.

Fact Number Two is this: Even if this session of Congress does not add any new programs or increases to the budget, the level of Federal spending will go up. The reason is that there are built-in increases in existing programs which are now producing and will continue to produce an up-curve in expenditures. The catalog of built-in increases covers such programs as outer space, civil aviation, public works, merchant shipping, urban renewal, science education, medical research, public assistance, loans abroad, and veterans' pensions. The farm program may become even more costly unless the Congress can find solutions faster than the farmers can increase their crop production.

Now, for 1961 alone, these built-in increases came to over $2 billion. That is why this budget is up over 1960. And for 1962 there are already in sight similar built-in increases of another billion dollars or more. Of course, there are a few built-in decreases, since Government programs once begun are usually incapable of being turned off. A year ago the President in his Budget Message listed 18 programs which should be revised or ended to bring about future savings. The Congress acted on only three, and when we came to do the arithmetic we found that instead of reducing future expenditures they had increased our commitments by about $9 billion.

Fact Number Three is that our national debt of $290 billion is a long way from being all that we owe for the past. Here are some of the things it does not include: our already accrued liability for military retirement is about $30 billion, and our unfunded accrual for civil service retirement is another $28 billion; on top of these, the future bill for veterans' pensions, compensation and other benefits will come to about 300 billions. These are obligations we have taken on for past services.

Now, the 290 billions of public debt, plus 360 billions for past services, plus $100 billion of C.O.D.'s adds to the almost unbelievable total of nearly $750 billion.

That is the magnitude of the Federal Government's mortgage on America's future. And it is the kind of information that has to be included in any meaningful balance sheet of our Government's resources and liabilities. It is information of the greatest importance to every taxpayer in the country.

And *Fact Number Four* comes next. We know that the pressures for new spending are still very strong. A table in the Congressional Record showed that in the last session of the Congress alone, 20 major spending bills in the Senate along with another 20 introduced in the House, for new programs, altogether priced out at more than $326 billion over a five-year period. While there may be some duplication among them, if these and other bills were passed as their sponsors would like, they would add $50 to $60 billion a year to what we are already spending in our annual budgets.

Looking Ahead

In the face of these fiscal facts of life, what choices do we have for the future and what do they signify?

There are two ways of looking at the future, one pessimistic and one hopeful. The important thing is that the American people can decide which route to take.

On the pessimistic side, there is a mortgage of $750 billion that will have to be paid. Built-in increases will push expenditures up, year after year. Pressures are mounting to have the Federal Government take over more and more of local government's responsibilities, and to meet demands for more spending on many fronts. Unless we pick our way carefully, we could soon have 100 to 150 billion-dollar budgets, along with higher taxes or bigger deficits, debasement of our money, and weakening of our economy.

But it need not be that way. On the optimistic side, the real possibility of reducing Federal spending lies in what happens in the world. If we could reduce and ultimately remove tensions in international relations, with a secure disarmament agreement, we could get by with much less spending for defense. We would not have to continue to spend 54 cents of every tax dollar for national security.

Beyond this, we can expect that if normal economic growth continues it will carry our Gross National Product close to the 750-billion-dollar mark by 1970, and without risky artificial stimulants. That kind of growth spells more wealth, more income, greater well-being. It means that we could make conscious decisions as to what share we want to take in taxes. For example, if taxes were to continue at 16 per cent of GNP we would be taxing ourselves 120 billions in 1970, or 40 billions more than now. It is not too soon to plan what we want to do with that added income. Unless we let it go by default to Parkinson's second law, which is, that spending rises to meet income, we have the opportunity to take care of real national needs and at the same time to reduce the debt or relieve the tax burden, or to do some of both.

As I said, the American people will choose which of these routes they wish to take. I hope the choice will be the right one.

We must decide now where our priorities lie, and in my view there are three: First, to provide for a strong national defense, with the fervent hope that this necessity will be temporary and rapidly decreasing.

Next, to work for a strong economy and a sound currency, because these are essential to healthy growth and the maintenance of our position in the world. This means balanced budgets, a continuing fight against inflation, a realization that no benefits can be provided from Washington that are not paid for sooner or later directly in taxes or indirectly through inflation.

And lastly, to work for the most effective use of our resources for domestic purposes, to find the right priorities, to end the old and advance the new, to recognize the competition among purposes and keep them in proportion, to build on partnership between Government and the private enterprise economy in seeking our goals.

Conclusion

And so I return to my starting point, to "the world's biggest balance sheet." Perhaps the day is far removed when the total financial picture of the Government of the United States can be summarized in a conventional-appearing balance sheet.

But we need not wait for Government to develop such accounting. Every one of us has a responsibility to examine the strengths and the weaknesses of our governmental system from time to time. Only when we are armed with facts, rather than impressions or illusions, can we express ourselves on the course which we would have our Government follow.

On these two principles: citizen responsibility and a passion for the facts, rests our whole idea of democratic government. We have claimed that this is the best of all systems, but we have never claimed that it is the easiest.

And we can learn from history that economic soundness does not guarantee a nation greatness, but that without it no nation can be great. Greatness is our goal. The eyes of the world will chart our progress and judge our endurance. Exuberance alone will not suffice. What is needed is the disposition to conserve our resources, to live within our means, and to cultivate a passion for realism.

CHAIRMAN McCOY: Thank you, Mr. Stans, for sharing this brilliant analysis of our fiscal situation with us at this crucial time in our nation's history.

It is now my pleasure to present Mr. William M. Black, partner, Peat, Marwick, Mitchell and Company of New York, Chairman of the Board of Nominations of the Accounting Hall of Fame, who will present the nominee of the Accounting Hall of Fame.

The certificate will be presented by Dr. Carson.

MR. WILLIAM M. BLACK: Mr. Chairman, honored guests, ladies and gentlemen: On behalf of the Board of Nominations of the Accounting Hall of Fame, it gives me a great pleasure to present their report to you.

Maurice Hubert Stans, widely known among accountants for his contribution to the development of current accounting thought, is also equally well-known in the national community for his services to the United States government. His work as Deputy Postmaster General of the United States, and his assistance to the Congress during the review of the 1954 federal budget led to his appointment in 1958 as the Director of the Bureau of the Budget of the United States.

Mr. Stans' contribution to the development of current accounting thought, and his administrative leadership in the profession are varied. He was a member of the American Accounting Association's Committee on Accounting Concepts and Standards, and of the American Institute of Certified Public Accountant's Committee on Accounting Procedures.

He has been a contributor of the *CPA Handbook*, and he has also contributed to other handbooks, and has written numerous papers for journals on accounting and related fields. He has served the Illinois Society of Certified Public Accountants as a director and editor of *The Illinois Certified Public Accountant*. He has served the American Institute of Certified Public Accountants as President.

His meritorious service has brought him the Alpha Kappa Psi Award in 1952, and the American Institutes of Certified Public Accountants' annual Award in 1954. Mr. Stans began his professional career with the firm of Alexander Grant and Company in 1928, and he was the executive partner of that firm when he entered government service in 1953.

For his contributions to the profession and to the nation, the Board of Nominations is proud to present Maurice Hubert Stans. (Applause)

DR. CARSON: Maurice Hubert Stans, stern defender of the public treasury, courageous exponent of good management in government, enemy of inflation, and persistent advocate of balanced budgets, in behalf of The Ohio State University, its faculty and its administration, it gives me great pleasure to admit you to the Accounting Hall of Fame. In testimony thereof, I hand you this certificate and extend our heartiest congratulations. (Applause)

MR. MAURICE H. STANS: My friends, when the Hall of Fame was originally initiated some 10 years ago, I was a member of the Nominations Board. I know from that experience the care and discrimination and effort that takes place in a democratic way in the selection of the designees for the Hall of Fame.

I knew, too, many of those who have preceded me in the selection for the Hall of Fame. I know of their great abilities, their great character, their tremendous contributions to the teaching of accounting, to the development of accounting as a great force in the growth of the nation.

All of this makes me deeply humble as I receive this Award. The honor is an overwhelming one. I accept it with great humility, with a heart full of gratitude, and with a promise to all of you that I will do my best to be worthy of it. Thank you very much. (Applause)

CHAIRMAN McCOY: The following message was received for communication to you at this time.

"Before leaving for the Summit Conference in Paris, I want to send my greetings to those attending the twenty-second annual Institute on Accounting, and my congratulations to their distinguished guest upon his election to the Ohio State University Accounting Hall of Fame. As Director of the Budget, Mr. Stans is a symbol of the growing participation of the accounting profession in public affairs. Our nation relies on men of his stature to produce timely and accurate records of past and present performance for guidance in policy decisions. Please give him my warm regards. Dwight D. Eisenhower, the White House, Washington, D. C." (Applause)

We will adjourn, with a rising vote of thanks to the Honorable Maurice H. Stans. (Standing ovation)

FIFTH SESSION

FRIDAY, MAY 20, 10:00 A.M.
The Ohio Union—West Ballroom

Presiding:

CHARLES J. GAA, *President, American Accounting Association; Professor of Accounting, Michigan State University, East Lansing, Michigan*

Paper: "The Effect of Tax Accounting Rules on the Continued Development of Sound Accounting Rules and Principles"

WALLACE M. JENSON, *Partner, Touche, Ross, Bailey and Smart, Detroit, Michigan*

Paper: "The 1960's—Decade for Depreciation Decisions"

FRANK V. OLDS, *Assistant Comptroller, Chrysler Corporation, Detroit, Michigan*

Paper: "Responsibility of the C.P.A. in Tax Practice"

ALBERT H. COHEN, *Manager, Tax Department, Price Waterhouse and Co., New York, New York*

FIFTH SESSION

Professor Clayton Grimstad: Ladies and gentlemen: I have two tasks to accomplish this morning, both short, and both pleasant. The first is simply to say good morning to you, and we are glad to have you here at this session of the Institute on Accounting.

The second equally pleasant task is to introduce Dr. Charles J. Gaa, Professor of Accounting at Michigan State University. Dr. Gaa has held positions in industry, government and public accounting. But he is primarily a teacher.

He is a product of Illinois. He holds three degrees from the University of Illinois, having received his Ph.D. there in 1940. He is also a CPA from Illinois. He left the academic life in 1954 to become a Director of the Advanced training Center of the Internal Revenue Service. Then in 1956 he became Assistant Dean of the School of Business Administration at the University of Michigan, and returned to his first love in 1958 when he went back to Michigan State as a teacher.

He is a member of numerous organizations, among them the American Institute of Certified Public Accountants, Beta Alpha Psi, and Beta Gamma Sigma.

He has, however, been most active and most noted for his activity in the American Accounting Association, of which he is now President. Ladies and gentlemen, Professor Gaa.

Chairman Charles J. Gaa: Ladies and gentlemen: I do not know whether you noticed or not, but this appears to be the Michigan session of the Ohio Institute, because the three speakers and the presiding officer are either in Michigan or exiles from Michigan.

Our subject, income taxation, is a fascinating but certainly an elusive one. I think it was very well described by one writer who said this about it: "It is not alone a legal field, but a mixed and specialized conglomerate of law, accounting economics, political whimseys and expediencies, and administrative edicts, smeared across the stark reality of revenue requirements of the government."

It is all of these things, plus a little idealism, I suppose, and perhaps too much self-seeking.

The income tax, of course, is extremely complex, but there does not seem to be too much relief in sight. Simplicity and the need for restraining tax avoidance and giving justifiable relief are not entirely compatible. Consequently we have new situations to reflect. We have to refine old provisions. The result is perhaps the most prolific technical literature of any field. And then as practitioners and teachers, our urge is to keep ourselves familiar with even the smallest details. We fear we will become incompetent because we have forgotten so many details.

I would like to quote something from Randolph E. Paul on this subject: "This situation makes the tax expert a near-sighted person. His struggle to master details obscures the general pattern from his vision, and his knowledge of this general pattern is where his greatest value lies. His real contribution should be a judgment and maturity that must have deep sources. His constant need, therefore, is a refreshment of his basic outlook."

I think that is what we are going to get from our three speakers this morning, a basic outlook.

The first subject is "The Effect of Tax Accounting Rules on the Continued Development of Sound Accounting Rules and Priciples." I think that we are all interested in seeing that the tax rules adhere as closely as possible to our accounting concepts, standards and rules, and certainly we want to avoid having the tax rules distort our general accounting rules.

I would like to give you a brief summary of the background qualifications of our very able speaker on this subject, Mr. Wallace M. Jensen. He is a Certified Public Accountant, and graduate of the University of Wisconsin. He is the executive partner for tax in Touche, Ross, Bailey and Smart of Detroit, but he is to move to New York in August.

He has served the American Institute of Certified Public Accountants as a member of the Council, as Vice President, as General Chairman of the Committee on Federal Taxation. He is past President of the Michigan Association of Certified Public Accountants. He is a member of the American Accounting Association, and the National Association of Accountants, and was a member of the Advisory Committee appointed by T. Coleman Andrews, Commissioner of Internal Revenue.

His public service includes the presidency of the Better Business Bureau of Detroit, membership on the Committee on Taxation of the Chamber of Commerce of the United States, and a member of the Budget Committee, United Community Services of Metropolitan Detroit. Mr. Jensen.

THE EFFECT OF TAX ACCOUNTING RULES ON THE CONTINUED DEVELOPMENT OF SOUND ACCOUNTING RULES AND PRINCIPLES

WALLACE M. JENSEN
Partner, Touche, Ross, Bailey and Smart
Detroit, Michigan

In retrospect my subject seems much broader than was originally intended. It could extend to many phases, such as the "net of tax" presentation in financial statements, the tax rules with respect to deferred income, and others. It was meant to cover the area of changes in accounting method and the confusion and potential controversy inherent in this field. I believe that many taxpayers and their accountants are not as aware of the problem as they should be and it could have some effect in delaying the continued development and improvement of financial statements. It is an area in which I actively participated as General Chairman of the A.I.C.P.A. Committee on Federal Taxation from 1956 to 1959. I know from that experience that some certified public accountants are concerned over the confusion, the trend, and the possible ultimate effect on the continued development of sound accounting rules and principles.

Prior to the enactment of the 1954 Code our federal income tax laws had contained only brief provisions dealing with methods of accounting. These provisions were re-enacted in the 1954 Code without any change in substance. The general rule continued to be that "taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books." The 1954 Code, for the first time, included a provision dealing with the requirements for requesting a change of accounting method, which merely codified existing regulations.

When proposed regulations under Section 446, "General Rule for Methods of Accounting," were issued in December 1956 the A.I.C.P.A. Committee strongly protested them. We believed that the proposed regulations were too restrictive and created the impression that, before a taxpayer could make any change in the method of accounting used in keeping his books, he must first secure the consent of the Commissioner. We pointed out that that would be impractical and impossible. The proposed regulations failed to recognize that there were many existing divergences between tax accounting and generally accepted accounting principles. The Congressional record contained ample proof of such divergences, and we referred to the report submitted to the Committee on Ways and Means in December 1953 by the A.I.C.P.A. Committee on Accounting Principles for Income Tax Purposes, the enactment of Sections 452 and 462 in the 1954 Code and their subsequent repeal in April 1955. We stressed that the regulations should squarely and clearly deal with the basic fact that the determination of income for accounting purposes had not been and may never be synonymous with the determination of taxable income. This protest was accompanied by a number of specific criticisms of the proposed regulations.

Thereafter we conferred with officials of the Treasury Department and the Internal Revenue Service with respect to some of the points which we had made. When the final regulations were issued in December 1957, we were pleased to note that some improvement had been reflected. Even so, the regulations injected some new and different requirements.

For instance, Section 1.446-1(a) defines the term "method of accounting" as including not only the over-all method of accounting of the taxpayer but also the accounting treatment of *any item*. The regulations continued to recognize that no uniform method of accounting could be prescribed for all taxpayers and that each taxpayer was free to choose that method which best suited his needs. No method of accounting was acceptable unless in the opinion of the Commissioner it clearly reflects income. Any method of accounting once adopted must be consistently adhered to from year to year.

With respect to the requirements for changes in an accounting method, the regulations provided in Section 1.446-1(e)(2)(i) as follows:

> " . . . a taxpayer who changes the method of accounting employed in keeping his books shall, before computing his income upon such new method for purposes of taxation, secure the consent of the Commissioner. A change in the method of accounting includes a change in the over-all method of accounting for gross income or deductions, or a change in the treatment of a material item. Consent must be secured whether or not a taxpayer regards the method from which he desires to change to be proper. Thus, a taxpayer may not compute his taxable income under a method of accounting different from that previously used by him unless such consent is secured."

It will be noted that a change in accounting method includes a change in the treatment of a *material* item. That requirement had its source in the Senate Finance Committee Report which indicated that a change in the method of accounting would be confined to a substantial change as distinguished from each change in the treatment of each item. It will also be noted that the regulation recognizes that changes may be made in the method of accounting used in keeping the books but establishes requirements for prior approval before such changed method may be used for the purpose of computing taxable income.

Both the proposed and final regulations continued the requirement that an application for approval of a change in accounting method must be filed with the Commissioner within 90 days after the beginning of the taxable year in which it is desired to make the change. The A.I.C.P.A. Committee pointed out that that requirement was unduly restrictive. The need for making a change in the accounting methods usually can not be anticipated and frequently develops as a result of business transactions occurring later in the taxable year. Sometimes the decision to change is not made until the end of the year as a part of the annual examination by its certified public accountants. It was recommended that it would be preferable that an improvement in accounting methods be given effect in the year which demonstrated the need for change. However, our suggestion that the taxpayer be permitted to file the application within a reasonable time after the close of the taxable year was not adopted in the final regulations. Accordingly, we are still faced with the problem that, if a change in accounting method is made in the books, it frequently cannot be given effect for tax purposes until the subsequent year, and then only if the Commissioner grants permission. This requirement alone will continue to create more divergences between book and tax accounting.

Another important change in the 1954 Code was the enactment of specific provisions dealing with the tax effect of adjustments required by changes in accounting method. I have reference to Section 481. There had been no comparable provision under the 1939 Code but certain rules had been developed as the result of court decisions. It had become fairly well accepted that, if a taxpayer initiated a corrective change from the cash to the accrual method (whether through formal application or an unpermitted change), the Commissioner could tax all of the opening accruals in the year of change. Likewise, if the Commissioner initiated the corrective change, he could not tax the opening accruals in the year of change on the grounds that such amounts were properly taxable in an earlier year. For all practical purposes, an impasse had been reached with the Commissioner and many wrong basis taxpayers doing nothing to effect changes, each waiting for the other to make the first move.

In Section 481 Congress established the principle that the transitional adjustments resulting from a change in accounting method must be made in the year of change to prevent a duplication or omission of income or deductions. No distinction was made as to who initiated the change. Recognizing the rule established by the courts, the pre-1954 adjustments were excluded from the application of the section.

The result was that many taxpayers who had been on wrong accounting methods saw the possibility of a windfall and either requested permission to change or made the change in accounting method for the purpose of computing taxable income without permission. So many applications for changes in accounting method were filed that early in 1956 the Commissioner announced that no action would be taken until regulations were issued. Regulations continued to be delayed and finally at the request of the Treasury Department Section 481 was amended by the Technical Amendments Act of 1958.

Under Section 481, as amended, pre-1954 adjustments must also be taken into account if the change is initiated by the taxpayer. If the Commissioner initiates the change, the pre-1954 adjustments would continue to escape taxation. The adjustments resulting from the change in accounting method must be taken into taxable income in the year of change, except that to ease the burden upon taxpayers where the pre-1954 adjustments exceed $3,000, that portion of the adjustment may be spread ratably at the election of the taxpayer over ten years beginning with the year of change. The post-1953 adjustment, however, still must be reflected in the tax liability for the year of change.

Instead of solving the problem of what happens when a change in accounting method is made for tax purposes, the enactment of Section 481, even after amendment by the 1958 Act, seems to have created many new problems. A review of some of the rulings and decisions which have been handed down dealing with this provision will demonstrate some of these problems.

One of the first decisions was *Alta Co-operative Elevator*, T. C. Memo 1959-33 (decided February 25, 1959). The taxpayer had for many years been deducting state income taxes and property taxes in the year paid for both book and tax purposes, rather than in the year accrued. In 1954, however, the taxpayer doubled up and deducted both the 1953 taxes paid in 1954 and the accrual for 1954 taxes. The Commissioner challenged the doubling up but accepted the change to the accrual method for taxes and disallowed the tax paid for the prior year. The taxpayer contended that it had accomplished a change in accounting method, that the Commissioner had approved the change by his action, and that it was entitled to a double deduction in 1954. In its opinion the Tax Court held that it was not a change in accounting method and upheld the Commissioner by allowing only the deduction for accrued taxes. Incidentally, the Court mentioned that Section 481 applied only to a change from one correct method to another, both of which clearly reflected income, which statement seems erroneous.

Subsequently the Tax Court opinion was vacated and a revised opinion, T. C. Memo 1959-102, was issued on May 19, 1959. The Court noted that the Commissioner had stated that a question of policy had arisen with respect to the position taken by him on the issue relating to the deductibility of taxes, and that the Commissioner subsequently had conceded the double deduction in 1954 and requested that the original opinion be vacated. Since the taxpayer acquiesced in the proposal, the Court did vacate the original opinion and the revised opinion contained no comment with respect to the Section 481 problem. Presumably the original decision establishes no precedent.

Shortly thereafter the Service issued Revenue Ruling 59-285, I.R.B. 1959-36, 32, which was stated to be applicable to both the 1939 and 1954 Codes. It held that taxpayers who have consistently deducted a material item in the year paid rather than the year accrued must obtain the prior consent of the Commissioner before changing such method of accounting, whether or not the taxpayer regards the method from which he desires to change to be proper. The ruling gives as examples the possibility of a change from the cash basis to the accrual basis for deducting property taxes or vacation pay. It should be noted that this ruling is just the opposite of the initial holding by the Tax Court in its original opinion in the *Alta Cooperative Elevator* case.

In January 1960 the Tax Court rendered a decision in *Southeast Equipment Corporation*, 33 T. C. No. 79. The taxpayer therein was engaged in the business of sewer and excavation contracting. For 1953 and prior years it had kept its books and filed its returns on the cash basis. In 1954 the taxpayer changed to the accrual basis at the end of the year and filed its 1954 return on the accrual basis without excluding its beginning inventory and receivables. Upon examination of the return the Commissioner accepted the change in accounting method and proposed a deficiency on other grounds. In its petition to the Tax Court (filed before the Technical Amendments Act of 1958 was enacted) the taxpayer claimed the right to exclude the beginning inventory and receivables.

The Tax Court held that the change had been initiated by the taxpayer and had not been required by the Commissioner, that, under Section 481 as amended, the adjustments required by the change must be reflected in 1954 taxable income, and that the taxpayer cannot "unmake" the adjustments. The Court also held that the retroactive amendment of Section 481 by the 1958 Act was not unconstitutional. The Court noted that the taxpayer had filed a timely election under the 1958 Act to take the pre-1954 adjustments into account over the ten years beginning in 1958, and presumably the case was closed on that basis.

Just last month the Service issued a ruling which has stirred up a tempest in my home state of Michigan. I refer to Revenue Ruling 60-133, I.R.B. 1960-15, 14, which was based on Technical Information Release 214 issued on March 14, 1960. The ruling holds that the mere change of a state law purporting to advance the assessment and lien dates for property taxes from January 1 to the preceding December 31 will not for federal income tax purposes give rise to a deduction of more than twelve months' property taxes in any one calendar year by accrual method taxpayers. The ruling applies to Michigan, South Carolina, and West Virginia property taxes. Although the Michigan statutes were changed in 1958 in somewhat the same manner as the Ohio property tax laws were changed in 1957, the Service will not permit Michigan taxpayers a double deduction for property tax in 1958, even though the ruling specifically states that a prior favorable ruling issued on Ohio taxes, namely, Revenue Ruling 57-616, C.B. 1957-2, 305, would be respected and not reversed. Needless to say, I have talked with no one outside of the Service who sees any merit to the later ruling or who believes that it will withstand challenge.

The most important part of this ruling for the purpose of today's discussion, however, is the portion of the ruling which holds that a change of accounting method is involved. In the ruling the authority of the Commissioner to require the determination of taxable income by accounting methods which, in his opinion clearly reflect income is asserted. The ruling goes on to conclude that under such authority the accounting method must reflect the consistent practice of deducting only 12 months' property taxes in the taxable year, irrespective of a change in state law accelerating the time as of which liability for the tax is incurred. If this principle were to be given effect broadly, no taxpayer would be permitted to deduct more than 12 months' expenses (and presumably should not report more than 12 months income), irrespective of any change in business practices or governmental laws. It is obvious why this ruling does not make sense.

I have reviewed these recent rulings and decisions for the purpose of demonstrating that we have a real problem today as to what constitutes an accounting method and a change in an accounting method for federal income tax purposes. Of course, we have all been aware that the basic accounting principle of recognizing that costs and expenses directly identifiable with revenues are chargeable against the income of the period in which the revenues are recognized has never been fully acceptable for income tax accounting purposes. However, the fundamental tax accounting rules with which we had become familiar are not now being respected by the Service except where it is to the advantage of the Service to apply them. While the Service is undoubtedly motivated by its desire to protect the revenues, it is believed that some workable basis for correcting and improving the method of accounting used for tax purposes must eventually be worked out.

For example, many businesses start out as small business and do not always determine the correct accounting treatment of items which are not material in amount. As the business grows it may find that expenses such as vacation pay and state income taxes have become so material that they should be accrued rather than treated as an expense when paid. Where the change in accounting method would operate to accelerate a deduction, an application for approval for a change in accounting method would apparently be futile under present conditions. Needless to say, many of these taxpayers will take the matter into their own hands, make the change, and await challenge at the time of examination of the return. There is no real double deduction involved but merely an acceleration of the timing of a deduction. Incidentally, by taking this action, even though not authorized by the statute, the taxpayer may place himself in a better position in so far as the application of Section 481 is concerned.

If the adjustment which would result from a change in accounting method is an upward adjustment resulting in an acceleration of the time for realization of taxable income, then a taxpayer may be more reluctant to make the change initially in its accounting records. As an example, one taxpayer for good business reasons initially adopted and for many years maintained a policy of valuing a class of its inventory at a nominal value. The Service was aware of that practice and approved it for many years. In World War II taxable years the Service challenged the method of inventory accounting and required a change to the lower of cost or market basis and excluded the beginning inventory adjustment. The taxpayer acquiesced in the settlement on that basis, changed its books accordingly, and has since reflected the lower of cost or market value method in its annual financial statements. The Service, however, immediately after the change had been made in the taxpayer's books, reversed itself and put the taxpayer back on the nominal value basis.

Now, after 10 years have elapsed, the Service is again challenging the inventory valuation of that same class of inventory. The Service has now taken the position that it is entitled to correct the inventory value by recomputing the ending inventory and allowing no exclusion for the pre-1954 adjustment which is required under Section 481 where the Government initiates a change in method of accounting. The Service has taken the position that it is merely a correction of an accounting method and not a change of accounting method and that the method of valuation used in the taxpayer's books is the correct method. This case is headed for the courts at the present time.

How does all of this affect the continued development of sound accounting rules and principles? As I see it, where a corporaton has adopted conservative methods of accounting which, in time, may result in a material understatement of an asset such as inventory, the corporation may resist change in its financial statements because of the possible tax disadvantages. For instance, some businesses have never included overhead in inventory but there may come a time when for business reasons the amount of such overhead attributable to inventory becomes so substantial that it should be reflected in the financial statements. Of course, in the case of publicly held companies changes in the method of accounting where material items are involved frequently must be made for book purposes, even though not for tax purposes. Once the change is made on the books it may carry a presumption that it more clearly reflects income. If the post-1953 adjustment is large enough in relation to the possible tax-free pre-1954 adjustment, then the Service may be more inclined to force the change for tax purposes as well.

However, it is my thought that many closely held corporations, particularly tax conscious ones, would prefer to have their auditors take exception to the method used in their financial statements rather than initiate the change for book purposes even though not for tax purposes. In such a case, it may be to the advantage of the corporation taxwise to wait for the Government to force the change, as the question is less likely to be raised.

There is a possible solution to this problem. The A.I.C.P.A. Committee on Federal Taxation made a legislative recommendation in 1956 and again in 1958 to the effect that adjustments applicable to the period prior to January 1, 1954, resulting from a change in accounting method, should not be eliminated. In other words, the Committee believed that as a matter of fundamental principle no double deduction should be allowed nor should income escape taxation.

Furthermore, as a longer period of time elapses since the 1954 Code was enacted, the amount of adjustments since 1953 which must be taken into account as taxable income in the year of change of an accounting method may become so substantial that a business could ill afford the full impact of the payment of the tax in one year. It would seem reasonable to permit the tax adjustment, whether upward or downward, to be spread over a period of years, either over a specified period or such shorter period as the taxpayer and the Commissioner may agree upon.

It also seems to me that we need greater flexibility in making changes of accounting for tax purposes. Instead of making the taxpayer obtain the prior permission of the Commissioner it would seem to make sense to permit the taxpayer to make such changes in method of accounting as he can justify as being necessary. Rules could be established requiring adequate disclosure, not only in the return but directly to the Commissioner if necessary. This would seem to permit adequate policing to prevent abuse of the greater freedom of action on the part of the taxpayer. Such a liberalization, combined with the taxation of the pre-1954 adjustments as well as the post-1953 adjustments and a spreading of the tax effect, should allow the necessary discretion to the taxpayer.

In conclusion, I think that it is evident that our tax rules regarding changes in accounting methods are in a state of confusion. There is a trend toward dictation by the Service as to what method of accounting must be used by the taxpayer. What we really need is greater flexibility and a fair administration to permit the gradual accounting changes which are necessarily involved in the growth of a business and the evolution of general accounting principles. Accounting is not static and must, of necessity, keep pace with business changes. Accordingly, there is need for legislation to permit greater flexibility of change of accounting method for material items, spreading the impact on both the Treasury and the taxpayer, while at the same time preventing abuse of the privilege by either party. Then and only then will we be able to minimize the effect of these tax rules on the fair presentation of financial statements.

CHAIRMAN GAA: Thank you, Mr. Jensen. The next subject, "The 1960's — Decade for Depreciation Decisions," with the presentation in part through visual materials.

This subject is also very much alive. The symposium volume was published in 1959 by the Tax Institute. *Depreciation and Taxes* is one of the series of volumes on the impact of taxation on management responsibility. It contains interesting and controversial materials. Our present speaker has a section in that volume entitled "Establishment of Priorities in Tax Reform." As a matter of fact, our last speaker this morning also has a section in that volume on "Proposals for Depreciation Reform." I commend to you their selections, and that of Professor F. Hellmuth in the same volume on the subject of "Depreciation and Changing Price Levels: Fundamental Economic Issues."

Judging from the selections presented by our speaker in that volume, we should have a very interesting presentation of a point of view which must be considered.

Our second speaker, Frank V. Olds, Assistant Comptroller in the Chrysler Corporation, has an outstanding record of achievement and contribution in the area of taxation and public service. He was the Manager of the Tax Department of the Chrysler Corporation for nine years, before assuming his present duties as Assistant Comptroller.

He is the past President of the Detroit Chapter of the Tax Executives Institute, and presently is National Director. He is also Vice President and Program Chairman of the Detroit Control of the Controllers Institute of America and is Vice Chairman of its National Committee on Federal Taxation.

Mr. Olds is a Director of the Michigan Manufacturers' Association, and is Chairman of the Committee on Taxation of the Automobile Manufacturers Association. As did our first speaker, he also served on the Advisory Council, appointed by the Commissioner of Internal Revenue, in 1953. His committee work includes that of being a member on the Michigan State Aid Survey Committee on State Fiscal Affairs, and the Taxation Subcommittee of the Business Advisory Council for the U.S. Department of Commerce.

He attended Wayne State University and the Detroit Institute of Technology. Mr. Olds.

THE 1960's — DECADE FOR DEPRECIATION DECISIONS

FRANK V. OLDS
Assistant Comptroller, Chrysler Corporation
Detroit, Michigan

Back home in Michigan, interested parties recently undertook a healthy examination of the state tax structure with particular emphasis on problems concerned with state and local taxation of business. It was during this period that I discovered that aggressive Ohio tactics are not confined to the Cleveland Municipal Stadium or the Ohio State University gridiron. Your very capable Governor DiSalle took the occasion of our tax discussions to invite Chrysler Corporation to further expand its operations in Ohio. If Ohio will continue to maintain a favorable tax and business climate, it will certainly remain high on anyone's list for future industrial expansion.

At Chrysler, our Airtemp Division has been located in Dayton for many years and we recently completed what is probably the world's largest stamping plant at Twinsburg. It is particularly about plants such as our Airtemp and Ohio Stamping Plant that I want to talk to you today.

We all recognize the importance federal tax depreciation policy has upon capital investment. We also recognize the shortcomings of the existing policy. In drawing up and enforcing tax legislation governing depreciation, the government still tends to think primarily about the length of time it takes to tire out a piece of iron, and not about the ever-shorter length of time it takes a competitor, domestic or foreign, to make today's equipment hopelessly inadequate.

Our federal government should move quickly to strengthen the country, through depreciation tax reform, for the international competitive struggle of the 1960's. It should move toward the goal of allowing business sufficient deductions before taxes to replace its worn-out or non-competitive equipment at today's cost — not at what it cost 15 or 20 years ago under completely different conditions. Technological progress *and* inflation must both be taken into consideration in determining necessary depreciation allowances.

I am happy to say that committees of Congress have begun to move. The Senate Select Committee on Small Business after extensive analysis concluded that, "present depreciation policies do not sufficiently encourage the expansion of the national economy. Indeed, those policies have, in all probability, stifled economic growth." The Senate Committee recommended Congressional review of all practical proposals for (1) shortening the period for depreciating property, (2) permitting greater depreciation in the years immediately after purchase of property and (3) depreciating property on basis other than historic cost.

While it is encouraging to observe the activity of Congress in this area, it is discouraging to observe the inertia of the accounting profession. As members of the accounting profession, you have a great deal more to do with the ability of business to make capital investments than is generally attributed to you or that you attribute to yourselves.

In my opinion, the accounting profession has failed to adequately recognize the effect inflation has had upon reported earnings. Throughout the period of inflation we have experienced in this country, business in general has attempted to convince government, labor and others that corporate profits as they are reported are misleading; in reality a portion of the capital of business is being reported as income; and income taxes now represent a substantial capital levy.

I will not dwell upon the effect inventory valuations have upon profits in an inflationary period. The increased use of LIFO has substantially solved the inventory problem for book purposes. With enlightened tax administration, the problem will also be solved for tax purposes. However, the concept of depreciation as it is presently viewed by a majority of those in the accounting profession must be re-examined and altered if the depreciable asset problem is to be solved.

Depreciation is commonly recognized as a process by which the cost of depreciable assets is allocated over their estimated useful lives so that if the whole reported income of a business is paid to its owners, the owners will not later discover that the assets of the business have dwindled away. Providing replacement funds is *not* the generally recognized purpose of depreciation. It goes without saying, however, that any method of depreciation that fails to provide replacement funds sufficient to replace assets of a going business is not an adequate method for allocation of cost. I will therefore begin my analysis by a comparison of annual depreciation charges of a hypothetical business firm with the annual replacement costs of actual retirements of the business on a continuing basis.

For purposes of illustration, I have made the following assumptions:

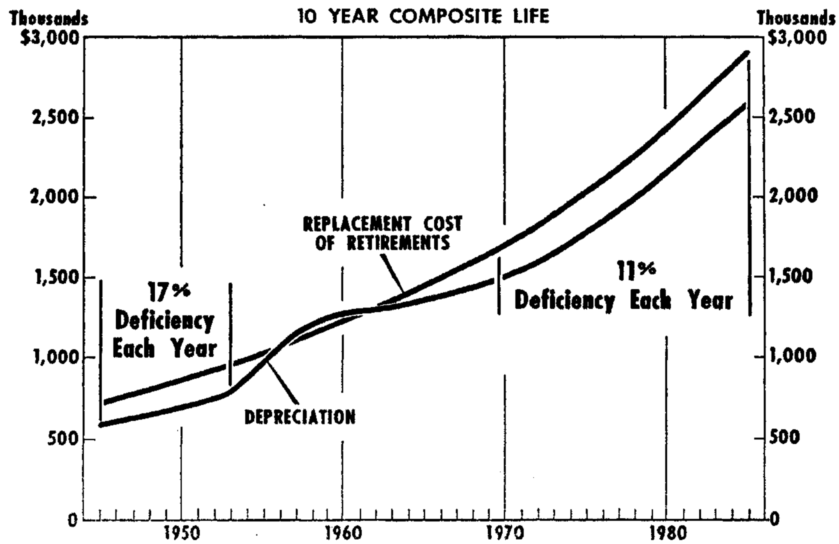
(1) each year's acquisitions are depreciated in separate group accounts,
(2) $1,000,000-a-year investments based on 1954 dollars,
(3) 3½% cumulative annual inflation,

(4) a typical retirement curve pattern, and
(5) a composite life of 10 years for each year's group account.

I have used the straight-line method of depreciating pre-1954 additions, and the sum of the year-digits method on post-1953 additions. In no case has any salvage value been recognized.

On this basis, this illustration closely approximates the machinery and equipment depreciation and retirement experience of typical manufacturing companies on a continuing basis, exclusive of investment for expansion.

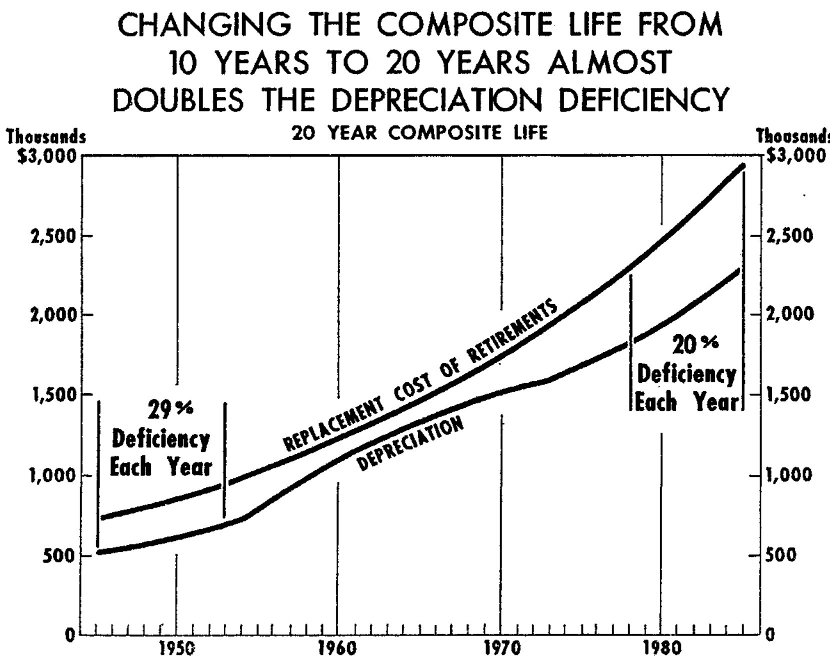
SUM OF THE YEARS - DIGITS METHOD REDUCES THE DEPRECIATION DEFICIENCY ONE-THIRD



From Chart No. I, it will be observed that in years during which the straight-line method of depreciation is used exclusively, depreciation charges fall substantially short of providing funds sufficient for the replacement of facilities — by approximately 17 per cent each year. In the years immediately following adoption of the sum of the years-digits methods of depreciation, depreciation charges more closely approximate, in some cases temporarily exceed, replacement expenditures. However, after the favorable initial impact of the adoption of the sum of the years-digits method, depreciation charges again fall short of supplying replacement funds — by approximately 11 per cent each year.

The accelerated methods of depreciation authorized by the Internal Revenue Code of 1954, while perhaps artificial, have nevertheless temporarily reduced the impact of inadequate depreciation charges as a restrictive force on capital formation.

The basic conclusion to be drawn is that typical business, by using commonly accepted accounting methods of depreciation, have in the past substantially overstated profits by failing to make adequate allowance for depreciation. Assuming continuation of a relatively modest inflationary trend, in the next few years profits will again be substantially overstated.



By using a composite life of 10 years, I have presented an overly optimistic illustration from the standpoint of business. Chart II assumes a composite life of 20 years. I have charted depreciation using the straight-line method on pre-1954 additions and the sum of the years-digits method on post-1953 additions. Consistent with the first illustration, I have assumed an annual investment of $1 million based on 1954 dollars adjusted up and down to reflect an annual cumulative inflationary rate of 3.5 per cent. I have also charted the replacement cost of retirements based upon the survival curve assumed.

It will be observed that an annual depreciation deficiency of 29 per cent existed in the years during which the straight-line method of depreciation was utilized. After a temporary narrowing of the gap between depreciation and replacement costs of retirements, depreciation again substantially falls short of replacement costs, levelling off at about a 20 per cent annual deficiency.

Doubling the composite life almost doubles the annual depreciation deficiency.

These examples illustrate a basic fact of historic cost depreciation accounting in a period of continued inflation: the longer the useful life, the greater the illusory profit reported.

In line with this fact, it should be recognized that one of the principal elements contributing to capital erosion today is that tax depreciation allowances are being spread over too long a period of time. Depreciation policies have simply not kept abreast of the speed of technological change.

One of the major risks inherent in automation is the rapid obsolescence of the facility itself. Let me draw an illustration of what I mean from our own experience at Chrysler Corporation. Only eight years ago our De Soto Engine line was one of the show places of the entire industry: Engineers from all over the world considered our plant to be the last word in engine building equipment. Three years ago that plant became obsolete and had to be completely replaced.

This illustration is not an island in the stream of progress. With other equally vivid examples, it forms the obsolescence pattern industry today experiences as a result of the rapid development of science and engineering.

There is, of course, no question about the imperative need to keep abreast of technological growth. The individual company must keep pace or go out of business. But in a larger framework, the advantages to the nation as a whole are immense. Fundamentally, it is investment in new and more efficient equipment that creates new and better products as well as increased productivity. By increasing productivity, we create the only sound and non-inflationary basis for raising wages and salaries. And this sound economic base makes possible an adequate investment by the country as a whole in the tools of civilization.

To achieve the private and public benefits offered by technological developments, sizeable amounts of capital are required. Where does business get the funds to make investment on the necessary scale? It is obvious from the Charts I have presented that present-day depreciation policies fail to provide sufficient capital even for the replacement of existing facilities.

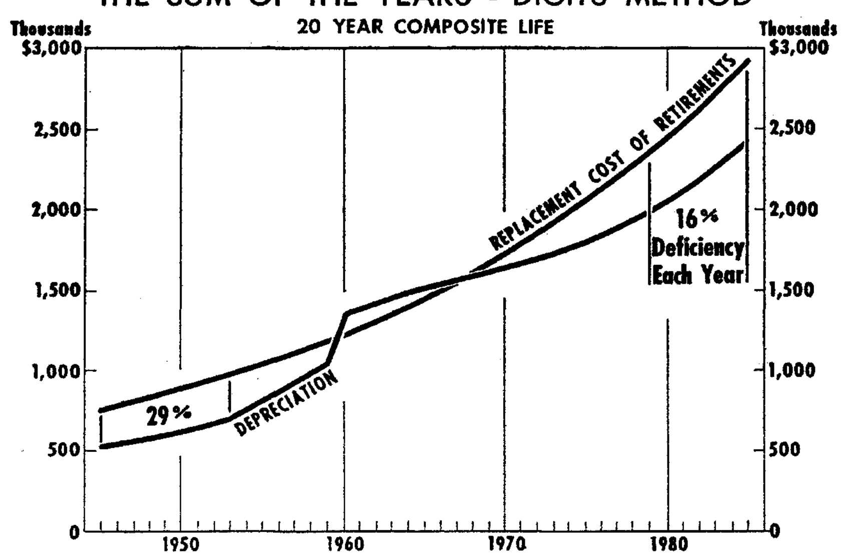
It might be well to observe that while after-tax corporate profits have fluctuated very narrowly over the past decade, depreciation charges have risen substantially. In 1958, for the first time since the 1930's, depreciation charges actually exceeded corporate profits. Emphasis has shifted sharply from undistributed profits to depreciation as the primary internal source of funds. It is more important than ever that the depreciation question be solved.

While I have stressed the importance of realistic lives as a basis for depreciation, a deficiency of existing tax policy and not of accounting policy, the matter of methods is primarily, or at least initially, an accounting problem.

Let us, therefore, briefly examine two of the alternative methods of depreciation that have been advocated in recent months — the triple declining balance method and the 20 per cent initial allowance method.

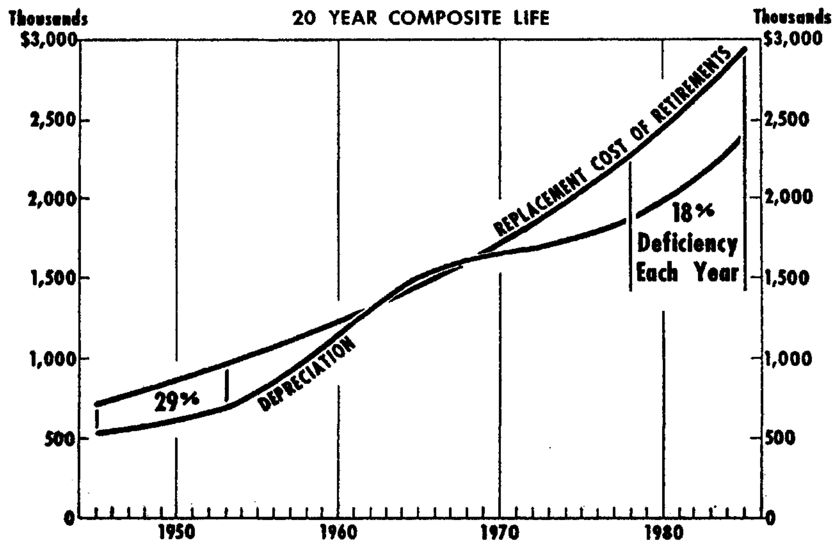
While it would be appropriate to analyze the effect of these proposed methods at varying levels of inflation and on various replacement patterns, time will limit our analysis today to application of these methods, beginning with 1960 additions, to group accounts with composite lives of 20 years. By using a 20-year composite life, I have used what I believe to be a conservative composite life for all depreciable assets of a business.

THE 20% INITIAL ALLOWANCE METHOD
IS A 20 PERCENT IMPROVEMENT OVER
THE SUM OF THE YEARS - DIGITS METHOD



On Chart III you will notice that the triple declining balance method of depreciation will result in a temporary excess of depreciation over replacement costs. In approximately six years, however, deprecation would again fall short of replacement cost. In the long run, increased acceleration using the triple declining balance method is a 10 per cent improvement over the sum of the years-digits method. However, substantial annual depreciation deficiencies will continue to result—approximately 18 per cent per year.

THE TRIPLE DECLINING BALANCE METHOD
IS A 10 PERCENT IMPROVEMENT OVER
THE SUM OF THE YEARS - DIGITS METHOD

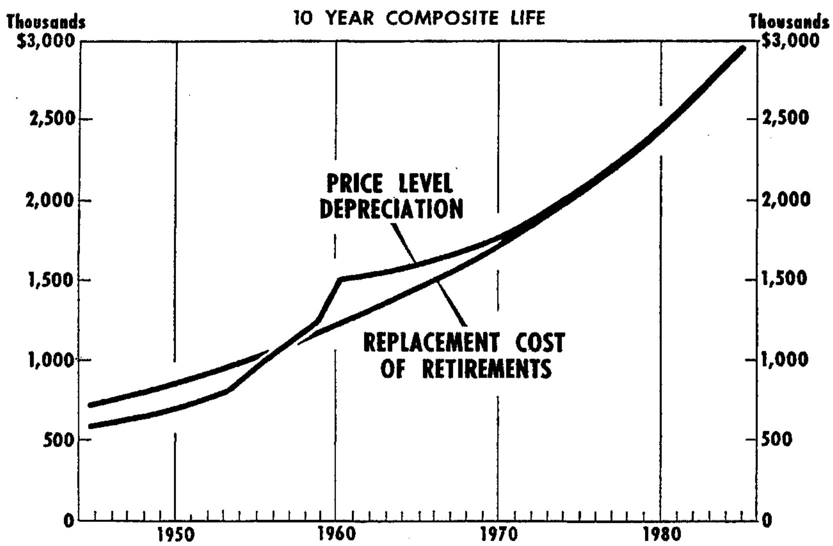


On Chart IV you will notice that the 20 per cent initial allowance method, as presently authorized for tax purposes for small business on a limited scale, would, if applied to industry generally, provide depreciation sufficient to meet replacement costs for approximately the next six years. Thereafter, however, depreciation would again fall short of replacement costs and average out to a 16 per cent annual deficiency.

With the adoption of either of these methods, we may well attain the optimum benefits offered by the use of accelerated methods.

Having disposed of the illusion that methods of acceleration would ever satisfactorily solve the long-term depreciation problems caused by inflation, let us look at the results a price-level method of depreciation would produce. Using the basic assumptions of the assumed taxpayer in

PRICE LEVEL DEPRECIATION IS THE ONLY METHOD THAT WILL PROVIDE REPLACEMENT FUNDS IN AN INFLATIONARY PERIOD



my first illustration, i.e., a 10-year composite life, and further assuming that the sum of the years-digits method of depreciation accurately reflects the pattern of wear and tear on the taxpayer's depreciable asset investment, on Chart V I have depicted, beginning in 1960, the results attained by adjusting annual depreciation charges by the price level change between the year of depreciation and the year of acquisition. You will note that after a brief period of adjustment resulting from the aftermath of utilizing the straight-line method on pre-1954 additions, depreciation charges exactly equal the replacement cost of retirements on an annual basis.

The temporary excess of depreciation over replacement costs would in no sense be a tax windfall to business or a misrepresentation of accumulated earnings. It would, in fact, be a recognition of a portion of prior year deficiencies. The tax dollars that would be provided would in part enable U. S. business to replace obsolete machinery and equipment and make it fully up-to-the-minute, ready to compete in the world market. Incidentally, it has been estimated by McGraw-Hill that the amount needed to make up that deficit is in the neighborhood of $95 billion.

In the long run, a satisfactory solution to the depreciation problem can be obtained only by the adoption of some method of price-level depreciation.

You might ask, is management really concerned about the effect the reporting of phantom profits has upon its ability to maintain and increase its capacity? I can assure you that industry is, and has been for many years, most concerned about the problem of confiscating capital resources under the guise of taxable income and the illusory reporting of profits. Many corporations recognized and acted upon the depreciation question caused by inflation long before accelerated methods of depreciation were authorized for tax purposes. Chrysler Corporation was, I am happy to say, one of the first to act. In 1947, Chrysler Corporation adopted an accelerated method of depreciation for book purposes. I quote briefly from the President's letter to shareholders accompanying the 1947 Annual Report.

> "If present price levels continue to rise, it is apparent that the ultimate replacement problem can only be met, without resort at some time in the future to capital financing, by accumulating cash balances from current operations. Your management has this firmly in mind in determining the Corporation's fiscal policies, but as yet no method of dealing with this matter in corporation accounting reports seems to have been devised and accepted into common practice.
>
> Because of the disturbed price levels, it has been decided to modify at this time the Corporation's depreciation policies by accelerating the charges for the early years of productive use of facilities . . ."

By the illustrations I have presented this morning, I hope I have awakened, or perhaps reawakened in you, a realization of the very real importance depreciation plays in the life of industrial corporations. Without adequate capital for replacement of facilities, there can be no timely stemming of the irresistible march to the junk pile of America's superior industrial machine.

The problem of the shortage of capital funds must be recognized. Moreover it must be recognized not as of limited application to one corporation or one industry, but as a factor that materially restricts the formation of capital and adverse to the public interest. To reaffirm this conclusion, I believe it necessary only briefly to review the depreciation policies adopted by countries with which we compete in the world market.

From a survey on foreign depreciation policies, however brief and superficial they may be, two points stand out. First, these countries recognize the important part adequate depreciation allowances play in the building and maintenance of a dynamic industrial economy. Second, and most important, they have without exception been more progressive than we in the United States have been in adopting needed depreciation reforms.

In conclusion, I believe that most of you here today accept the fact that you or your clients have been adversely affected by inflation as it relates to the higher cost of replacing plant and equipment. I urge you, and fellow members of the accounting profession, to act affirmatively upon the problem. The decade of the 1960's is truly "The Decade For Depreciation Decisions."

CHAIRMAN GAA: Thank you Mr. Olds. The last subject is "Responsibility of the CPA in Tax Practice."

It seems to me that one of the important developments which must take place for a more satisfactory administration and practice of the federal income tax is a better relationship between the tax practitioner and the revenue agents. There appears to be too much suspicion and hostility on both sides in many instances — perhaps some of it is justified — but it must be reduced. We ought to be working toward a position of mutual respect and trust between professional men who find themselves as adversaries in a tax controversy.

Some four or five years ago, Coleman Andrews, then the Commissioner of Internal Revenue, saw the necessity for trying to establish a truly professional service within the IRS, and he took some steps in that direction.

The problem from the point of view of the Certified Public Accountant is being discussed by our next speaker when he talks about the responsibilities of tax practice. Mr. Cohen's background qualifies him very well to discuss this subject. He is the Manager of the Tax Department of Price Waterhouse and Company in New York. He was formerly Director of Taxation of the American Institute of Accountants. Presently he is serving on the American Institute's Committee on Ethics of Tax Practice.

He is a Certified Public Accountant, and holds the degree of Doctor of Philosophy in Business Administration from the University of Michigan. He has taught accounting, taxation and economics at several universities. Mr. Cohen.

RESPONSIBILITY OF THE CERTIFIED PUBLIC ACCOUNTANT IN TAX PRACTICE

ALBERT H. COHEN
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New York, New York

The problem of defining the basic responsibility of certified public accountants in the field of tax practice is presently the subject of active debate, but it is by no means a new or novel one. It seems fair to say that every CPA tax practitioner at one time or another has had to ask himself "What is my responsibility here?" in response to a challenging problem then confronting him.

The problem has not suffered from a lack of consideration. But the consideration that has been given and the decisions that have been reached by individuals have not been widely communicated to others; they have not been coordinated, guided, summarized and codified, or run the gauntlet of exposure to profession-wide analysis and critique.

The net result is that at the present time there is no unified statement of principles or standards to guide CPAs in their own conduct of tax practice or on which individual practitioners may rely when their own actions may be questioned.

Problems of "responsibility," "ethics," or "standards of conduct" arise in various aspects of CPAs' tax practice, in the preparation of tax returns, in administrative proceedings before the Internal Revenue Service or the Treasury Department, and in tax planning and advice. Perhaps the most crucial area in which problems of responsibility arise is in the preparation of tax returns, however, even if for no other reason than that this area has received more widespread attention. Some background of what has happened in the fairly recent past is, I believe, necessary to a proper understanding of the nature of the problem and the possible direction of future events.

Several years ago a subcommittee of the Ways and Means Committee, known at the time as the King Subcommittee, made a comprehensive study of tax administration, including the role played by tax return preparers. A report prepared and issued by the King Subcommittee expressed concern that in some cases tax evasion was being encouraged by unscrupulous tax practitioners. Largely as a result of the King Subcommittee's recommendation, the federal income tax returns for several years contained a statement to be made by the taxpayer indicating whether or not he had paid anyone for assistance in the preparation of his tax return and requiring the taxpayer to disclose the name of the person rendering assistance. However, apparently largely because of space limitations in the tax return forms themselves, the current income tax returns do not contain such a declaration by the taxpayer.

Even more recently there have been repeated indications that, among laymen, there may be a general, basic misunderstanding of the functions actually performed by certified public accountants and others in the preparation of tax returns in the bulk of tax return preparation engagements. For example, during hearings in 1958 directed at obtaining information for possible legislation in the labor field, Mr. Hoffa, President of the Teamsters Union, and the accountant who prepared his income tax return, were questioned at some length by Senator Kennedy on the matter of Mr. Hoffa's income tax returns. At one point during the interrogation, Senator Kennedy questioned the accountant in regard to a substantial item of income which appeared on Mr. Hoffa's return. On the return the income was described in a vague manner, which gave no indication as to its source. In response to the questions of Senator Kennedy, the accountant who prepared the return stated that he had received the information upon which the questioned item was included in Mr. Hoffa's return from Mr. Hoffa over the telephone, and, based solely on that telephone conversation, he had included the item of income in the tax return. This led Mr. Kennedy to comment that this procedure was apparently a deviation from what he had generally assumed was done by certified public accountants when they prepared tax returns for clients. The accountant in the instant case was a certified public accountant, and Mr. Kennedy stated his belief that when a tax return was prepared by a certified public accountant the return was based upon an "audit" of the information contained in the return, and that the CPA preparing the return, by signing the jurat, "certified" the reasonableness and accuracy of the information contained therein.

In another instance, although the details varied somewhat, substantially the same type of misunderstanding among members of Congress regarding what CPAs actually often do in the preparation of an individual income tax return was apparent during the recent hearings before Congress in the matter of Bernard Goldfine.

Each of these instances by itself might be viewed simply as an isolated misunderstanding by a person uninformed of both the basic facts of tax administration and the manner in which most CPA tax return preparers (at least in so far as individual income tax returns are concerned), accumulate the information upon which a tax return is prepared. However, other contemporaneous events have served to highlight the problem of adequately defining the responsibility of the CPA in tax return preparation and in other fields of tax practice.

One of these is the recent revision of Circular 230, which sets forth rules governing the enrollment of agents and attorneys to practice before the Treasury Department and the rules which must be followed by enrollees in such practice. The other recent development is a study, which has received no publicity and of which little is known, begun last year by the staff of the Joint Committee on Internal Revenue Taxation into the regulation of tax practice. The heightened interest in tax administration at the legislative level is indicated by the fact that in the Spring of 1959 the Ways and Means Committee devoted two full days to an interrogation of Treasury and Service officials; copies of the proceedings have not been, and may never be, released to the public.

On October 4, 1958 the Treasury Department published proposed changes in Circular 230. These were published after discussions had taken place between representatives of the Treasury and the American Institute of CPAs regarding some of the problems that had been encountered with the provisions of the prior Circular 230. For the most part, however, the discussions between the representatives of the Treasury and the accounting profession centered mainly on Treasury proposals governing the extent to which unenrolled persons would be permitted to represent taxpayers in proceedings before the Internal Revenue Service. Problems other than those arising in this area received only brief attention in these preliminary discussions.

In the proposed revision of Circular 230 no substantial changes appeared in the provisions relating to enrollment and practice by CPAs before the Treasury Department, at least in those covering the responsibility which tax return preparers necessarily assume. In conjunction with the revision of Circular 230, however, there was a substantial rearrangement of the provisions which had been contained in the earlier version. Because of this rearrangement renewed attention was directed to the provision which imposes upon enrolled persons the responsibility for exercising "due diligence" in certain aspects of their activities. In particular, the proposed revision of Circular 230 contained the following provisions in Section 10.24:

> "Section 10.24. Diligence as to Accuracy. — (a) *In general.* — Each enrolled attorney or agent shall exercise due diligence in preparing or assisting in the preparation of, approving, and filing re-

turns, documents, affidavits, and other papers relating to Internal Revenue Service matters.

"(b) *Representations to Service.* — Each enrolled attorney or agent shall exercise due diligence to determine the correctness of representations made by him to the Internal Revenue Service."

This provision did not represent a substantial change in substance from the former version of Circular 230. In Section 10.2(w) the following had appeared:

> "Section 10.2(w). Preparation of documents by enrollees. — Each enrolled person shall exercise due diligence in preparing or assisting in the preparation of, approving, and filing returns, documents, affidavits, and other papers relating to Treasury Department matters, and in otherwise representing clients before the Treasury Department; . . ."

From a comparison of the quotations above it can be seen that the only change was to include the requirement for "due diligence" under a heading which relates the diligence to "accuracy." Nevertheless, this provision in the revised version of Circular 230 (which was issued in final form in November of 1958 without substantial change from the proposed Circular 230) has created considerable concern that the intent of the Circular is to impose upon certified public accountant enrollees a greater degree of responsibility than is imposed upon unenrolled persons who prepare tax returns or upon persons who are enrolled as attorneys or agents, but who are not CPAs. This concern stems largely from the fact that elsewhere in the Circular enrolled agents who are certified public accountants are required to conduct themselves and their practice before the Treasury Department in accordance with the "recognized ethical standards applicable to certified public accountants generally." This has concerned some on the ground that it may be interpreted to require that a certified public accountant must independently ascertain for himself the accuracy of the information reflected in an income tax return before he is able to sign the jurat that appears on the face of the return. In effect this interpretation would make the position taken in Statement No. 23 on Auditing Procedure applicable to tax return preparation.

If Statement No. 23 were applicable to tax return preparation, a certified public accountant would not be able to sign the jurat on the tax return without modification unless he had actually conducted an audit and was in a position to express an opinion as a CPA on the fair presentation of income in the information contained in the tax return. Otherwise the CPA who prepared a tax return would be required to qualify the jurat in some manner to indicate that he did assume less responsibility than he assumes in the case of audited financial statements.

The concern of representatives of the accounting profession that this latter interpretation might be officially adopted by the Treasury was such that representatives of the AICPA in discussions with Treasury and Internal Revenue Service personnel specifically raised the question whether any shift in prior policy was intended by the provisions of revised Circular 230. Informally it was indicated that no change in policy was intended. There has been no official public announcement to this effect, however, and, in the absence of such a statement of official policy, it is reasonable to expect that uncertainties will continue to exist as to the degree of responsibility assumed by a CPA who prepared and signs a tax return.

As an example of these uncertainties take the statements made by Mr. John P. Weitzel, Deputy to the Secretary of the Treasury, before the AICPA annual meeting in San Francisco last October. At one point in his talk, which appeared in *The Journal of Accountancy* for February, 1960, he stated:

> "A number of questions have been raised by certified public accountants as to whether the language relating to 'due diligence' as to accuracy found in section 10.24 in the revised Circular No. 230, and which differs somewhat from earlier language, was intended to place a greater burden upon CPAs, particularly in the preparation of tax returns, than is imposed upon enrollees. *You may be assured there was and is no such intention.*" (Emphasis added.)

If Mr. Weitzel had stopped at this point, perhaps many in his audience (and his readers) would have been relieved of some of the concern which was generated by the revision of Circular 230. But three paragraphs later, in what is in effect a summation of the current "due diligence" rule, Mr. Weitzel declared:

> "A still uncharted area exists when we consider whether an accountant has a duty to verify facts and figures presented to him by his clients, even though they may appear to the accountant to be accurate and reasonable on the face."

In this one brief paragraph Mr. Weitzel not only summarized the problem of the accountant's responsibility in tax return preparation, but clearly implied that insofar as the Treasury is concerned, at least, the problem is as yet unsolved.

The degree of responsibility which an accountant assumes when he prepares and signs a tax return is a problem which in some cases may extend beyond simply the accountant and the Treasury Department itself. It must also be noted that the Department of Justice can become involved in matters involving criminal prosecutions, and the Justice Department would not be in any way controlled by the Treasury Department's attitude on what constitutes a proper activity by an accountant in tax return preparation. In fact there has been at least one instance in which representatives of the Department of Justice suggested that an accountant might be guilty of criminal tax fraud in the preparation of a business return which contained illegitimate deductions, even though the accountant was not aware of the nature of the deductions and their nature was not disclosed by the type of examination conducted by the accountant in good faith.

The problem cannot be viewed lightly. Fundamentally the question which must be answered is whether a federal income tax return is a "financial statement" in the generally accepted sense of the term so that when prepared by a certified public accountant the standards of preparation imposed by the rules of professional conduct apply just as in the case of any other financial statement. Since the basic provisions of Auditing Statement No. 23 are now incorporated in the rules of professional conduct as Rule 19, a certified public accountant would not be able to sign the jurat appearing on tax returns without qualification unless he had satisfied himself independently as to the accuracy of the material information reflected therein. Thus the problem boils down to one of interpretation of professional ethics.

The Committee on Ethics of Tax Practice of the AICPA has viewed the problem in the same light. This committee was first formed in 1958 as the Committee on Tax Accounting Practice. During the 1959 Spring meeting of the AICPA Council, the Chairman of that Committee presented to Council a recommendation that the Committee on Professional Ethics be instructed to consider the application of the normal rules of professional conduct to the field of tax practice in general, and to the preparation of tax returns in particular. After considerable debate, a motion was made and passed by Council directing that an effort be made to develop a code of ethics applicable to tax practice, with the responsibility for such effort to be at the discretion of the President of the Institute.

Subsequent to the formal Council session the President of the Institute instructed the Committee on Ethics of Tax Practice to proceed, as its main current activity, with the development of a proposed code of ethics to be observed by CPAs in tax practice, but that before submission of proposals to Council, comment and criticism should be secured from the Committee on Federal Taxation.

The development of such a proposed code of ethics in tax practice will be a difficult task, replete with controversial issues, and results cannot be expected in the immediate future.

A second step which might be considered concurrently is the renewal of efforts to have a "multiple block" type of jurat adopted for tax returns. Several years ago the Treasury Department was receptive to a recommendation made by the AICPA Committee on Federal Taxation for a jurat which would permit the preparer of the return to indicate more concisely than is possible with the present jurat the basis upon which the information reflected in a tax return was accumulated. However, the proposal failed of acceptance largely because of objections from representatives of the bar and from taxpayer groups. Fundamentally these objections stemmed from the possibility that the proposed form of jurat might place persons other than certified public accountants at a competitive disadvantage in tax return preparation.

Whether an effort at the present time to secure the adoption of such a form of jurat would be successful, or even wise, is problematical. Because it has so recently revised Circular 230, and because for the moment the Treasury is not involved in the middle of an active dispute between CPAs and attorneys concerning the respective role of each profession in tax practice, the Treasury may be reluctant to take steps at this time which could possibly create an area of substantial disagreement between attorneys and CPAs.

It should be pointed out in connection with the jurat on tax returns, that the Treasury's original interest in the possibility of designing a jurat which would permit the preparer of the return to indicate the basis upon which the information was accumulated was that this information would be helpful to the Treasury Department in selecting returns for audit. There was no implication in the Treasury's general acceptance of the multiple block jurat idea that it would be willing or able to accept a jurat signed by a CPA as carrying more responsibility than a jurat signed by others. Suggestions that the Treasury Department accord such acceptance to returns prepared by CPAs have been made recently in some quarters, but in all fairness, we cannot reasonably expect the Treasury to give up its own responsibilities to any professional group, no matter how well disciplined. Furthermore, because of the nature of an audit performed by a CPA, even if it leads to a "clean" opinion on financial statements, I do not believe it would be possible for a CPA to vouch for the complete accuracy of all of the information reflected in a tax return based upon audited financial statements. In an audit the CPA is, of course, concerned with ascertaining that financial statements fairly present the financial picture of a company, and properly may disregard minor items on the basis of their immateriality. When it comes to the preparation of a tax return, however, those items may be of more significance.

Other substantial problems could certainly arise if the Department attached any great weight to a CPA's audit opinion beyond simply in selecting returns for audit. For example, a serious problem of client relations could rise if the tax return jurat required a CPA to state affirmatively that he had performed an audit, but as a result of the audit was not able to give a "clean" opinion on the financial statements. Execution of such a jurat by a CPA tax return preparer might reasonably provoke inquiry by the Treasury Department, yet, obviously, in some cases the circumstances which gave rise to the qualified opinion (or no opinion) would have no real bearing on the determination of taxable income. Under these circumstances clients understandably might be quite concerned about the requirements of a multiple block type jurat.

Thus it would appear doubtful that clarification of the problem of CPAs responsibility can be secured in the near future through the adoption by the Treasury Department of the "multiple block" type of jurat. Perhaps more germane to the real problem itself is whether even the adoption of an expanded jurat would meet the ethical requirements of Rule 19, since it might be argued that the expanded jurat would simply permit an indication of the scope of examination conducted preliminary to expression of an opinion.

In view of the present uncertainties surrounding the basic problem of the CPA's responsibility in tax practice in general, and in tax return preparation in particular, it seems evident that guidelines are needed which will achieve observance and support from our profession as a whole. I believe it is of paramount importance that leadership in the formation of standards of conduct applicable to tax practice come from the profession itself. Abdication of our own primary responsibility in this matter can only lead to the imposition of rules by outside authority — which may well mean an authority insensitive to our own views and lacking an understanding of our own problems.

I believe that most of what I have said up to this point is not highly controversial. Now, however, when we come to discussing what should be done, we enter into an area where honest opinions may and do differ. So, trite as it may appear, I must observe that what I say represents my own opinions only — shared, perhaps by some — but different, I am sure, from those of others whose stature in the accounting profession commands my great respect.

If we are to develop workable and acceptable rules of conduct for CPAs in tax practice, it seems fundamental that we must accept certain basic principles of policy, and then proceed from there to more specific rules. Let me outline for you some basic principles which to me seem essential to observe in the formulation of rules of conduct in tax return preparation.

1. Any rules relating particularly to tax practice by CPAs must of necessity be in harmony with the rules of conduct governing professional accounting activities outside the area of tax practice. Because of this, sound policy requires that the profession avoid approval of any type of activity in the area of tax practice which might jeopardize its reputation in the accounting field generally.

   Here I think the problem is largely one of educating the public generally as to why there may appear to be different standards applied to tax practice. Actually, of course, CPAs generally must observe the same basic rules of moral and ethical conduct regardless of the area in which they may practice. The obligation to observe these basic professional responsibilities cannot be turned on and off depending on the type of work being done at the moment. The point that must be gotten across to the public is that what might appear to be differences in standards do not represent such a difference but merely arise in the application of the same standards to the different types of problems involved in tax practice as compared to those encountered in general accounting practice. We must educate the public generally to the unique type of ethical problems encountered in tax practice and how solution of those problems may be approached within the general framework of ethical standards applicable to accounting practice generally.

2. Basic to the development of rules governing tax practice is the fact that it would be clearly contrary to the interest of the Internal Revenue Service and the Treasury Department to limit severely the number of persons who are enrolled to practice before the Treasury Department and the number of persons whose services are available to the taxpaying public generally for assistance in the preparation of federal income tax returns. That the Internal Revenue Service

is not interested in limiting the number of tax practitioners is manifest by its recent action in permitting certain unenrolled persons to represent taxpayers in administrative proceedings before the Internal Revenue Service at the revenue agent level.

3. Any rules in this area must also take into account the fact that the preparation of tax returns and other tax services is an integral part of the package of accounting services which CPAs should be prepared to render to clients. Without question CPAs must be prepared to render tax services to those clients for whom regular accounting and auditing functions are performed if only that failure to provide such services would create an impossible position competitively.
4. Any rules to be formulated should recognize frankly that it is clearly within the scope of accounting practice to prepare tax returns for individuals and businesses, even where the taxpayers may not be regular audit clients. Not only may the preparation of tax returns and other tax work for such clients be profitable in itself, but such tax work often provides a valuable source of new accounting and auditing business, either directly or through the enhancement of the CPA's reputation which comes from doing valuable tax work for individuals and businesses. Often it can be demonstrated to a tax client that doing nontax accounting work as well would permit the CPA to give more effective tax service, as for example in day-to-day tax planning.
5. It would be unrealistic and undesirable to ignore the essential fact that any professional certified public accountant inescapably does assume more responsibility in tax practice than school teachers, bank clerks and others who may prepare tax returns. This additional responsibility stems not from the fact that the Treasury Department wishes to impose upon the accounting profession more mature responsibilities than upon members of other professions or members of no profession, but from the fact that the CPA's professional status requires that he utilize in all of his work those skills which, as a professional accountant, he is naturally expected to have. Among these skills which are important in the field of tax practice are the auditor's natural instinct for what is reasonable and proper, a high degree of technical competence in the income tax rules themselves, and an inquisitiveness beyond that normally expected of the average person.
6. When a CPA enters the field of practice he cannot shed completely

the independence which he prizes so highly in the field of auditing. There must be recognition, however, that the technical rules governing federal income taxation are not clear, concise, and capable of being applied to a set of specific facts without ambiguities arising or the possibility that the rules may be subject to more than one reasonable interpretation. Where areas of doubt do exist, it should be recognized clearly that the CPA's primary obligation is to his clients, and he should be free to resolve reasonable doubts in favor of the taxpayer, just as the taxpayer himself is entitled to do. To this extent in the preparation of tax returns and in representing clients in tax controversies the CPA serves in a sense as an advocate of the taxpayer's position. This does not destroy his real independence, however, since wherever there is a strong conviction that one technical treatment is correct and that a treatment supported by the taxpayer is improper, I believe the CPA has a professional duty to insist that the treatment he feels proper is followed. If under these circumstances a client is unwilling to accept the CPA's position, I believe the CPA cannot accede to the client's demands and still maintain his position of professional independence, even though the matter concerns only the tax return of a client.

Although, as I have indicated, I believe the CPA in tax practice in a sense acts as an advocate, it is necessary to distinguish this type of advocacy from the advocacy commonly adopted by attorneys in the various branches of legal work. The lawyer is expected to fight for his client with all the weapons available either for a tax point or for any other legal point, without necessary regard to his own opinion. The CPA, on the other hand, will fight for his client's tax position only if there is some reasonable support for that position, and if in the CPA's mind no such support exists, he should decline to accept the taxpayer's position. Under these circumstances, as I noted above, there may be no recourse except to break the client relationship. It should be understood, however, that this does not mean that the CPA must serve as an informer to the government.

To summarize, it does not seem likely that the Treasury Department realistically could take or wishes to take the position that certified public accountants must perform an audit in connection with the preparation of income tax returns, or that by preparing returns and signing the jurats on the tax return, certified public accountants express an opinion in the usual sense as to the accuracy of the information contained on the return. It is reasonable, however, for the Treasury Department to expect that a tax return prepared by a certified public accountant should not display inconsistencies or inaccuracies which a skilled accountant would normally be expected to detect based solely on the information available to him for the preparation of the return, whether supplied by the client or otherwise. In other words, I believe that a certified public accountant cannot absolve himself from responsibility for the accuracy of information reflected in a tax return merely by failing to ask questions which reasonably should be asked in the light of information presented to him or otherwise known by him.

On the basis that this is the degree of responsibility which now may be assumed by CPAs in the preparation of tax returns, it would seem to behoove members of the profession to adopt the policy of preparing tax returns from information furnished by the client, and not independently verified, only where there is confidence that the client is not engaging the CPA to use his high professional reputation to assist him to avoid or evade his responsibilities, and that deliberate failure to supply pertinent information cannot reasonably be anticipated. Furthermore, where apparent inconsistencies exist, or where there may be reasons to question the accuracy of information furnished by the taxpayer, positive steps should be taken to satisfy any doubts. Where doubts do arise which might require additional work on the part of the CPA he should secure authorization from the client to perform those steps necessary to resolve them. Failure to explain to a client under these circumstances that additional steps are regarded as necessary will almost certainly result in difficulties in securing an adequate fee for the services rendered. If additional steps are necessary to an independent inquiry as to the accuracy of information furnished, and the client declines authority to perform the additional work which is necessary, or refuses to supply the required information, I believe the CPA has no alternative but to decline to complete the preparation of the tax return and decline to sign it as preparer. As CPAs we cannot fail to perform necessary work on the basis that we will not be adequately compensated.

Now, in conclusion, let me summarize the essence of our problem. This is, that nowhere is there now an authoritative statement of generally accepted rules of professional conduct governing tax practice by CPAs. Each member of the profession has his own standards undoubtedly, but these may or may not be "generally accepted." Clearly the profession must attack this problem with united thought and action. No rules will achieve acceptance if they fail to recognize the practical realities of tax practice as actually carried on by CPAs, and realistic rules cannot be developed in a vacuum. More and more practitioners must be encouraged to express their own personal views, and as this takes place I believe a discernible pattern of what is now being done will emerge. It would then be possible to define the rules of conduct which are being followed by CPAs in tax practice.

Only after this point has been reached can we ask the question "Are these adequate?" The answer, of course, will not be simple or easy, but at least a start will have been made to develop rules which will be as authoritative as the rules governing CPAs' practice outside the field of tax practice.

CHAIRMAN GAA: I should like to express our appreciation for these fine talks we have heard this morning. This session is now adjourned.

SIXTH SESSION

FRIDAY, MAY 20, 12:30 P.M.
The Ohio Union—East Ballroom

Presiding:

E. H. EATON, *Vice President, Controllers Institute of America; Treasurer, Pittsburgh Plate Glass Company, Pittsburgh, Pennsylvania*

Presentation of Hermann G. Miller Memorial Scholarship

ROBERT A. DRAPER, *President, The Ohio Society of CPAs, making the presentation.*

Paper: "Adapting Corporate Policies to Changing Economic Conditions"
JOHN HART, *Controller, B. F. Goodrich Company, Akron, Ohio*

SIXTH SESSION

MR. WALTER BURNHAM: Ladies and gentlemen. It becomes my pleasure to present the presiding officer of the meeting today. We are especially happy to have him here, and fortunate to have him with us because he is on a very busy schedule. He flew in from Pittsburgh to attend this meeting. It is an especial honor, too, to present him because he is an Ohio State University graduate, and has risen to quite some fame in his own right.

I might tell you that he started as a mail clerk with Sears Roebuck; he ended up as Treasurer of the Pittsburgh Plate Glass Company of Pittsburgh. He is also the Vice President of the Controllers Institute of America. It gives me great pleasure to present to you Mr. Edward H. Eaton as the presiding officer.

CHAIRMAN E. H. EATON: Thank you very much. In behalf of the Controllers Institute of America I want to extend my thanks for the privilege of being here today. I am sorry that this schedule that has been referred to has resulted in my not being able to attend the meetings that have been conducted here yesterday and today. I understand you have had some excellent sessions.

It was my privilege to attend the first and second Institutes that were held at The Ohio State University when I was an undergraduate. So calling this the twenty-second annual Institute dates me very definitely. Incidentally, I was about as bald then as now.

I should like to introduce to you the people at the speaker's table, starting on my extreme right. Mr. Hobart G. Icenhower, President of Omicron Chapter of Beta Alpha Psi. My notes say that I should skip the next person. I think it would be a grave oversight, so let us have Mr. Burnham stand up and take a bow. Next is Albert H. Cohen, Manager of the Tax Department of Price Waterhouse and Company, New York, who was a speaker this morning. I will do some skipping here now. On my left is Mr. Frank V. Olds, Assistant Comptroller of the Chrysler Corporation of Detroit, who was a speaker this morning. Wallace M. Jensen, partner of Touche, Ross, Bailey and Smart, Detroit, also a speaker this morning. Charles J. Gaa, President of the American Accounting Association, Professor of Accounting of Michigan State University, East Lansing. Paul E. Fertig, Chairman of the Accounting Department at Ohio State University. Carson Cox, Associate Professor of Accounting, The Ohio State University, and General Chairman of this Institute Committee. I would like to call on Mr. Cox to introduce the members of the Institute Committee which provided this Conference.

PROF. CARSON COX: Thank you, Mr. Eaton. I am certain that all of you realize that this is not a one-man job. I would like to introduce the members of the Committee who have put on this program and ask you to hold your applause until all the members are standing, and then you can give them a good round of applause.

First of all, I would like to introduce the corresponding secretary. He has written several hundreds of letters about our program. Professor Paul Fertig. Another man who has had a great deal to do with the program, Professor Dan Shonting. Next, a man who has spent untold hours counting ballots, making marks on paper. Professor Lauren Brush, responsible for all the records of the Hall of Fame. Next, the man responsible for the details of arrangements, Professor Robert Neubig. And publicity, Professor Harry Lyle. President of Beta Alpha Psi, Hobart Icenhower. Now let us give all these men a round of applause. (Applause)

CHAIRMAN EATON: Thank you. I should like to introduce to you Mr. Robert A. Draper, President of the Ohio Society of Certified Public Accountants, who presided at yesterday morning's session. He will make an award of the Hermann C. Miller Scholarship Award.

MR. ROBERT A. DRAPER: Mr. Chairman, ladies and gentlemen: I am very honored to have the privilege of presenting the Hermann C. Miller Scholarship Award. Unfortunately for me, I knew Hermann only as an acquaintance, having first met him at an Ohio Society annual meeting about a dozen years ago. Even then I knew his reputation as an outstanding educator, but I soon discovered that was only half of the story. The other half of his twin professional interests was the CPA profession. The record shows that he served the Ohio Society well and in high office. From 1930 through 1934 he was the State Director from the Columbus Chapter. And his interest, ability and leadership were recognized by his election as President of the Ohio Society of CPA's for two terms in 1935 and 1936 — the only accounting teacher ever to head the Society.

At each annual Society meeting, it was always a pleasure for me to renew my acquaintance with Hermann, even if only for a brief greeting. It was quickly evident to me that although he had devoted much time in the past to the affairs of our Society, his continuing dedication to the high standards of the CPA certificate compelled him to participate in many discussions of Society Affairs.

Many of you have been attending this Institute on Accounting for years, and are well aware that Hermann Miller played a leading role in its inception and in making it grow to its present stature. Professor Miller's first love was teaching and after holding public and private accounting positions, he joined the staff of Wisconsin University, and then returned to Ohio State in 1926. I am sure that many of you here had the good fortune to study accounting under Hermann Miller, and I am also certain you would agree that he was one of the most influential men in guiding students toward the accounting profession.

Mr. Miller was named Chairman of the Department of Accounting at The Ohio State University in 1946, and the fact that he was widely recognized in the teaching profession is attested by his being elected President of the Grand Council of Beta Alpha Psi in 1941, and President of the American Accounting Association in 1947. He contributed many articles to professional journals and is widely known as the co-author with Jacob Taylor of textbooks on Intermediate Accounting and CPA problems. He was a member of the Executive Committee of the Commission on Standards of Education and Experience for CPAs, and was continually striving to upgrade CPA standards in Ohio and throughout the country. During both World Wars Hermann served in the United States Navy, and retired from the Naval Reserve in 1954 with the rank of Captain, having been Supervisor of Cost Inspection for the Fourth Naval District in World War II.

In 1957 Hermann Miller received the well deserved honor of being elected to the Accounting Hall of Fame at The Ohio State University in recognition of his distinguished service.

These brief recitations of some of Mr. Miller's many achievements can only hope to give those of us who did not know him well a small insight into his vigorous personality, strong convictions, and his dedication to both the teaching and the accounting professions.

Since his death in 1955 Hermann has been sorely missed by his many friends and associates. As a tribute to the memory of such an outstanding educator and member of his profession, the Hermann C. Miller Scholarship Fund was created by his Ohio Society friends and his many other friends who contributed so generously. It is the income from this fund which is awarded annually to a graduate student at The Ohio State University, who is preparing for a college teaching career. I am sure that Hermann Miller would have considered this to be a most worthy tribute.

This year James Bulloch has been selected by the Accounting Department Faculty to receive the Hermann C. Miller Scholarship Award. I would like Mr. Bulloch to stand here by me while I tell you a little about him.

The Michigan flavor of today's session continues, as you will see. Mr. Bulloch received his Bachelor's and Master's degrees from the University of Michigan. For two and a half years, he was on the staff of Gregg and Velker, CPAs in Ann Arbor.

Mr. Bulloch has been an Instructor in the Accounting Department at Ohio State for the past three years. Presently he is a candidate for the Ph.D Degree in accounting at The Ohio State University. He will join the faculty of the Business School at the University of Michigan as a Lecturer, beginning in September 1960. He is a member of the Ohio Society of CPAs, the American Institute of CPAs, the American Accounting Association, and Beta Alpha Psi. And I am very happy to hear that he is also interested in getting on with his golf game.

Mr. Bulloch, it is a pleasure for me to present you with the Hermann C. Miller Scholarship Award, evidenced by this certificate on which is inscribed: "For the year 1960 James Bulloch has been awarded the Hermann Clinton Miller Scholarship Award."

My sincere congratulations to you on this worthy achievement, and my best wishes for the continued success of your career.

MR. JAMES BULLOCH: To the members of the Ohio Society of CPAs and to the many other friends of Hermann Miller who made this Award possible, and of course, to the accounting faculty here at The Ohio State University, whose counsel and guidance and encouragement have been helping me towards this career, I am very thankful for this very wonderful honor. (Applause)

CHAIRMAN EATON: In introducing our speaker for this luncheon session, I have been given a biography. But I find that I have here a press release that I think covers it better, particularly because it points out a new honor that has come to him. So I am going to read the press release.

John N. Hart, Controller of the B. F. Goodrich Company since 1957, has been elected a Vice President of the company, it is announced by J. W. Keener, President and Chief Executive Officer. He will continue in the post of Controller.

A native of Ohio, he joined B. F. Goodrich in 1945 after serving as officer in the United States Navy during World War II. He was graduated from The Ohio State University in 1931, did graduate work there, and was a member of the faculty during which time he was also employed as Director of Research for the Ohio Department of Taxation.

His first company assignment was economist in the Business Research Department, after which he was Director of Personnel for Akron operations. In 1953 he was named Corporate Director of Employee Relations, and in October 1957 was elected Controller.

Mr. Hart is a member of the American Economic Association, the American Statistical Association, and the Controllers Institute of America. Civically, he serves as Chairman of the Child Welfare Board in Akron. He is also Vice Chairman of the Department of Church and Economic Life of the National Council of Churches. He and Mrs. Hart have four children, and they live in Hudson, Ohio.

It gives me great pleasure to introduce to you Mr. John M. Hart.

ADAPTING CORPORATE POLICIES TO CHANGING ECONOMIC CONDITIONS

John N. Hart
Vice President and Controller
The B. F. Goodrich Company, Akron, Ohio

The title of this talk, "Adapting Corporate Policies to Changing Economic Conditions," is so broad that it permits me to cover a wide variety of topics. However, this is a luncheon meeting, and I have done my best to fit my remarks into a reasonable time limit.

Changing economic conditions can be viewed from either short-term business cycle ups and downs, or from long-term trends. I have chosen the long-term route because I believe that what I can suggest in this area will be, over the long term, more significant.

In particular, we will look at the effects of the life and death of products on the profits of a corporation; the problems that are being brought about by subtle changes in the relationships between managers and owners; the phenomenon of shifting inventory patterns, and the knowledge and skills that are required of today's managers.

Our competitive enterprise system has often been labelled "dynamic" because of the continuous changes that take place within it. Change begets change, and these days when our economy is moving ahead at a rate of 3½ to 4 per cent a year, you have to move quickly just to keep your relative position.

To give you an idea of the changes that are presently taking place in the industrial world, the number of scientists, inventors and technicians working in research and development today is 500,000 compared with 70,000 20 years ago. Someone has figured out that 90 per cent of all scientists who have ever lived are alive today.

Of the sixty-odd billion dollars spent on research in the history of the United States, thirty billion — nearly half of it — has been spent in the past five years.

Since the results of scientific invention are cumulative, the rate of invention tends to multiply geometrically. There is a normal lapse of seven to ten years between discovery and ultimate application, so we can expect to see more new products in the 60's than ever before.

Some of these products will succeed; some will fail. Some will make a profit; some will lose money. The accountant can and should make important contributions to the profit ability of these new products.

One means to accomplish this end is to prepare well-conceived budgets that reflect managerial policy and provide detailed plans to convert policies into action. A budget attempts to predetermine in accounting terms the financial and operating results that are anticipated and provides a model which management tries to follow through conscious control of operations as they develop. Variations from budget because of volume, mix, prices and other causes must be forecast with respect to profits and costs.

The good financial organization anticipates these problems so that the accountant takes part in the "briefing session" before the flight, rather than second guessing at the "de-briefing" when the pilots have returned. The data gathered by the accountant serves as the intelligence which the economist and statistician use as their jumping off points.

However, it is too much to expect accounting procedures to tell you whether or not research expenditures are really productive or ample to insure survival.

The effect of the product life cycle on corporate growth has been under study for some time. Arch Patton of McKinsey & Company separates this cycle into four phases: introduction, growth, maturity, and decline.

He points out that there is no average life expectancy in a product life cycle. The dress designer, for example, can expect a full cycle in a season, whereas a furniture designer may hope to duplicate the success of a Chippendale chair with a design "good" for generations. Management must recognize the difference in functional emphasis which is required for success in different phases of the life cycle of a product. This implies ability to recognize the precise phase of the cycle and this is a very difficult job.

In the introductory phase, the critical ingredients are skills in research and engineering, and in testing and launching the product. This is usually a period of heavy losses due to small volume and high promotional costs. Once the product survives the introductory phase, it moves into the growth phase. This is the period of high and sharply rising profits. Results during this period become exceptional since soaring demand will cover up a "multitude of sins." During this period the consumer is lenient with all manufacturers and will readily accept, without complaint, products that in later stages he would not even consider buying.

As volume rises, the market becomes saturated, and we enter the maturity phase where marketing becomes the dominant element. Usually, in maturity all competitive products are reliable and there may be little to distinguish one from the other. Channels of distribution and images which have been built up in the consumer's mind are well established at this point and not likely to be changed.

In maturity, profit margins start to slip because price is the primary method of competition among most producers. It is during this phase that the manufacturer may tend to get closer to the consumer. This is done in order to protect the manufacturing profit by accepting a break-even or a loss, if necessary, at the branch or retail level.

Control of costs is very important in this phase and also in the last phase of the cycle, the decline phase. During decline, the dominant role of marketing is replaced by a need for coordinating control over all product costs — engineering, manufacturing, and marketing. Financial controls become increasingly important and the financial executive becomes the chief of staff to the executive with the over-all profit responsibility.

A mistake in the interpretation of the phase can be fatal in terms of commitment to the wrong policy, and a mistake is more likely in a management oriented to only one phase of cost. The average company will have many groups of products in various phases of their life cycles. Here both the economist and statistician play important parts in determining the phase of the product life cycle for each of the company's major products.

The use of the product life cycle concept can best be illustrated by two examples. In one, a maufacturer was considering an expensive advertising and promotional campaign in order to create a quality image for itself, until study showed the product to be in late maturity. There could be no recovery of this expenditure because margins were tight and would probably get tighter.

In the second case, a company was considering eliminating certain branches which were losing money, until study determined the product was mature and volume was a necessity. The study showed the company should have more branches rather than less in order to preserve its manufacturing profit.

Another of today's problems for the corporation is the growth of such institutional investors as life insurance, pension funds and investment companies. This has resulted in more and more separation of ownership from management and has come about because institutional investors usually do not like to be involved in proxy fights or other problems of this nature.

Up to this time, institutional investors have expressed their disapproval of a company only by selling stock. This is regrettable, because it leads to the possibility of management acting to perpetuate itself, once it learns that it is not accountable to its larger shareholders.

The increase of funds available to institutional investors has locked some of them into companies. Because of their large holdings, perhaps increased by stock growth, they cannot sell their stock without making a substantial tax payment.

This will require them to take more interest in the management of company affairs. Income and inheritance taxes have eliminated most of the large individual shareholders and their stock has been cut up among millions of new investors. This makes the voice of financial institutions all the louder in company affairs should they choose to exercise control. The magnitude of the institutional investors' holdings is best realized from the forecast of Vito Natrella of the Securities and Exchange Commission who estimates that pension funds alone will grow from their present $33 billion to $77 billion by 1965.

This divorcement of management from ownership has some strange results. One instance is noted in which the price of stock option for management was lowered after a bad year. The reason given for the reduction in price was that it was necessary in order to hold the management. The natural question that comes to mind is why this management should be held. Were they behind their competition and responsible for at least a share in the blame for the reduction in stock prices? Or were there other factors that caused the price of the stock to drop?

Here again we are in a period of change. I believe we will witness much additional legislation in the next decade because big investors are now increasing together with big business, big government, and big labor. In addition to the dangers of legislation, pity the executives of the company which is owned by a "growth" fund and an "income" fund!

Another long-term trend that is evident in today's economy is the backing up of inventories. Retailers are shifting the inventory burden back to the manufacturers and the manufacturer in turn is shifting the burden back to the raw material producers. Today retailers are carrying a smaller per cent of inventory than they did in 1947, a year when goods were in short supply and retailers' shelves were relatively bare.

How is this condition possible? Tremendous capital expenditures by manufacturers have led retailers to believe there is adequate capacity to produce for quick deliveries.

Production capacity is not the only element in this equation. Through the use of computers, companies today have a better idea of what and where their inventory is. They have almost instantaneous knowledge of sales as they are made, and can, therefore, adjust production schedules quickly and efficiently.

Application of more complete computer data allows inventory reduction in relation to sales or, the other side of the coin, more turns with the same inventory. Part of today's squeeze on margins as a per cent of sales is a result of this improved information. Additional turns of inventory make it possible to provide the same return on investment in spite of reduced turn on sales. Development of this information will be essential in order to survive.

The retailers have learned some new skills, too. This, coupled with the new skills and techniques learned by the manufacturers, enables the retailers to carry less inventory and still service their customers.

Here again statisticians and economists are becoming more important because manufacturers must have the right inventory, in the right place, at the right time in order to get their share of the business.

In our own industry an excellent indicator of total passenger replacement tire sales is the number of cars two years old, and older, which are on the road. Through use of this indicator our people are able to come very close to estimating the national total sales of replacement passenger car tires.

Our problem is to determine which brand: whether white or black walls; whether rayon or nylon; whether first, second or third lines will be sold in which city, in which month, and how much influence our advertising and other promotions can have on this consumer decision. We are spending a great deal of effort to improve this detail type of forecasting so we can carry less inventory without losing sales.

If you are questioning the importance of the inventory shift from the retailers, consider the following: if retailers were carrying the same proportion of inventories today as they carried from 1951 to 1955, their inventories would be $1 billion higher.

From the point of view of the economy as a whole, the most important effect of improved information on inventories will be to minimize inventory booms and recessions and therefore cause fewer and smaller fluctuations in the business cycle.

A further effect of the shift in inventories is the fact that the manufacturer is being forced to perform more and more retail functions. In order to control distribution, we find manufacturers setting up their own service organizations and also setting up more and more financing plans for dealers, including consignments.

This trend is forcing manufacturers into the retail business since there is little percentage in handling the retailing services without also receiving the retailing margin. This again poses problems of size as a manufacturer integrates both forward and backward in order to protect his manufacturing margins. Again, using our own industry as an example, we find recent announcements of one company's commitments in the retailing field and another's commitment to fiber manufacture.

The knowledge and the management skill required to handle the problems already mentioned, and others, is emphasized by the fact that in 1958 the total of "white collar" employment passed the total of the "blue collar" employment. Currently, the fastest growing group is professional and technical people. More of these are required to coordinate the larger and larger enterprises. As a result of having more of them it requires greater management skills to handle them.

Sheer size increases the demands on management skill. To use an example recently cited by Lt. Col. Lyndall Urwick, 100 corporations with 250 employees each call for 100 employees with the capacity of a captain or a major. If you put these 100 corporations together into one with 25,000 employees you still need the 100 captains or majors. In addition, you need 25 lieutenant colonels, 5 colonels, 2 one-star generals, and at least one three-star general.

Market studies and economics are becoming more important in today's enterprises because of the large capital expenditures and long lead time required to get into production. In our own case, our Board of Directors approved a new tire plant late in 1959 and this plant will not start production at Ft. Wayne, Indiana until late 1961.

The use of more and more technical people means that business firms do not have the flexibility in cost-cutting that they formerly had. The use of these people, with the long training periods involved, makes it necessary to take a long-range view to keep the organization intact rather than increasing and decreasing their numbers with the ups and downs of production.

The direction of these highly-talented people requires more general knowledge than was previously necessary. The managers must know something of the technical language in order to be able to communicate fully with the people.

We shall probably see industry revising its thinking about incentives and promotions concerning the highly talented people. The time may come when a scientist will earn more than his manager for this reason: to promote the scientist into a manager's job may mean that the company would lose a good scientist and gain a bad manager. So in order to keep the scientist doing the things he does best — and at the same time keep him happy — his salary limitations will need to be revised.

Most companies have probably underestimated their requirements for these highly talented people, and the increasing competitions for them will also push up their price.

Another need will be for management people capable of grasping the significance of large volumes of data, of organizing the data to show up the exceptions, and of taking fast action. The goal of electronic data processing is to provide a feed back control system which will permit a fast reaction to each business situation in much the same way as a chemical process is controlled.

In this connection, Dr. Jay Forrester of M.I.T. has used the driving of a car as an analogy on the present feed back control system for running a business. In driving a car the system operates from hand to steering wheel, to front wheel, to road, back to the eyes, to the arm muscle, and the hand again. This control is too perfect for business. We would be closer if we blindfolded the driver and had a companion in the front seat to watch where he is going and issue instructions to the driver. The driving will become much more erratic because of the time lag and the distortion of information from sight to voice.

Even this illustration is too perfect for our current industrial enterprise. In an industrial enterprise the companion issuing instructions would be restricted to looking out the rear window so that he could see where he had been but not where he was going. Through the use of computers, economists and statisticians, we are trying to avoid the last part of the analogy and make the operation of a business more similar to the usual pattern of driving a car. The computers are being used to shorten the time lag in information, and the economist and statistician to give us a forward look rather than the present backward look.

Mathematics is becoming increasingly important as a business tool and more and more managers will be required to have a working knowledge of it. It is the newer mathematics that is finding the greater applications in business and in order to make room for these, some of our traditional courses will need to be shortened. One college professor has suggested that algebra be pushed into the high elementary grades or the low junior high school grades. In addition, perhaps plane geometry, trigonometry, logarithms, and solid geometry should be eliminated from our high school curriculum. This would be feasible since the slide rule and calculator on the desk have replaced the book of logarithms in the drawer; also, it is no longer a necessity for each individual to be capable of surveying his own property. These changes would make way for some of the newer mathematics and also make possible an introduction to calculus and analytical geometry in our high schools.

In order to provide the proper knowledge and skill, many companies, including B. F. Goodrich, have established advanced management courses. Leading authorities lecture on their special fields and company officials relate the lecture to the company's situation. Since all the students are from the same company, the discussion of the lectures usually is tied directly to the company's own problems.

A business game is woven into this program with a number of fiscal quarters played near the start and additional fiscal quarters played the last several days in order to note the effect of the discussions and lectures. This course is normally conducted at a location away from company offices and has resident requirements in order to get the advantage of the evening discussions. This program is not a substitute for the broad type of management course offered at a university, but it should provide a company with faster and more tangible results than any other method.

During the same period new methods are being developed for teaching management skills, questions are being raised as to whether or not management is a profession which has transferable skills. Some students in this field feel that management ability is only transferable within a company or an industry and is not a true skill. A true skill could be transferred from one major sphere to another, and yet we see relatively few transfers of general managers from one industry to another.

Successful management requires knowledge of the people, the product, the technical matters, and the traditions of the company and the industry. Geologists often become presidents of oil companies because success in finding oil is one of the determining factors in the profitability of an oil company. In the immediate post World War II period, when production was the problem area, production people tended to be named as company presidents.

Today marketing and finance are the problem areas for most corporations and since we now have excess capacity in many industries, companies will tend to look to marketing and finance people to provide leadership.

We see then that we are in a period of rapidly changing philosophy with increased demands being made on management, new methods being developed to try to educate management to meet the demands, and questions being raised as to both the methods and the results.

All of the factors mentioned increase the pressure for better and more knowledgeable management, and we must all do our jobs in order to meet the challenge. These are the pressures that have resulted in reappraisement of our methods of teaching in business schools. The need for more knowledge at the general manager level has resulted in the pendulum swinging towards the more liberal arts type of education.

Many things which can be taught in business schools can be learned on the job just as well, or even better.

Ernest Breech, Chairman of the Board of Ford Motors, in dedicating his new school several weeks ago stated, "Every man in business should have a liberal arts background. It is my hope that the Breech School of Business Administration will graduate future business statesmen who are prepared in general knowledge and specific training to meet the problems of their time."

The role played by scientists, technicians, and mathematicians in tomorrow's business will be increased so that a broader background will be required of executives. This increasing complexity of internal operations requires more knowledge of how to coordinate people. Community responsibilities of big business impose requirements for greater social skills. Expansion abroad in the faster growing market requires broader geographical and physical horizons.

Business and education must join to develop the men capable of meeting the specifications and solving the problems that have been raised this afternoon. One short refresher course will not be enough because the manager who does not continually keep up with the times — or rather, keep ahead of the times — is sure to find himself as obsolete as the automobile tire innertube.

It has been a pleasure for me to be with you this afternoon.

CHAIRMAN EATON: Mr. Hart, thank you very much for an excellent discussion of the challenges that lie ahead of us. I think I am probably speaking for everyone to say I would like to sit down all afternoon to discuss this further. It is an excellent presentation.

If there are no announcements or other matters to come before the group, the meeting is adjourned, and this ends the Institute for this year. Thank you very much.

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Villhauer, Melvin H., Arthur Young & Co., Toledo
Volpe, A. N., Lybrand, Ross Bros. & Montgomery, Cleveland
Vozenilek, Emil L., The Wartburg Press, Columbus
Vukovich, Joe, The Youngstown University, Youngstown

Wackman, Kenneth B., Alexander Grant & Co., Cincinnati
Wallace, Bert W., Arthur Young & Co., Cleveland
Walters, Everett, (Dean), Graduate School, Ohio State University, Columbus
Walthall, S. Orville, Walthall & Drake, Cleveland
Ward, Robert F., E. W. Bliss Co., Canton
Ware, L. L., Touche, Ross, Bailey & Smart, Dayton
Waschak, Martin R., The Youngstown University, Youngstown
Weatherwax, Robert P., Armco Steel Corp., Middletown
Weeks, William C., Keller, Kirschner, Martin & Clinger, Columbus
Weidler, Walter C. (Dean Emeritus), Ohio State University, Columbus
Weidler, (Mrs.) Walter C., Columbus
Weis, Paul, North American, Columbus
Weyrich, Harry R., Haskins & Sells, Cincinnati
Wickham, Bill, (Student), Ohio State University, Columbus
Wieser, Charles E., Touche, Ross, Bailey & Smart, Detroit, Mich.
Wilkins, Charles, Haskins & Sells, Cincinnati
Willcox, (Mrs.) Russell, Columbus
Willis, Herbert H., Central State College, Wilberforce
Wilson, Frank E., Armco Steel Corp., Middletown
Wilson, Janet H., (Prof.), University of Dayton, Dayton
Wilson, Rex S., Wilson Accounting Service, Piqua
Wilson, Wilber W., Wilson & Smith, Newark
Woodruff, E. H., Farm Bureau Coop. Assn., Inc., Columbus
Wright, J. L., Touche, Ross, Bailey & Smart, Dayton
Wright, Jack L., Dayton

Yager, E. Ben, Miami University, Oxford
Yaple, Wendell E., Keller, Kirschner, Martin & Clinger, Columbus
Yocum, James, Bureau of Business Research, Ohio State University, Columbus

Zahn, John M., Ernst & Ernst, Columbus
Zanes, Robert G., Nationwide Mutual Ins. Co., Columbus
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Zimmerman, Vernon K., (Prof.), University of Illinois, Urbana, Illinois
Zuber, Gordon, Thompson Ramo Wooldridge Inc., Cleveland

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